

FOCUS ON A CHANGING JAPAN

HEARING BEFORE THE SUBCOMMITTEE ON ASIA AND THE PACIFIC OF THE COMMITTEE ON INTERNATIONAL RELATIONS HOUSE OF REPRESENTATIVES ONE HUNDRED NINTH CONGRESS

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WEDNESDAY, APRIL 20, 2005

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ASIA AND THE PACIFIC,
COMMITTEE ON INTERNATIONAL RELATIONS,
Washington, DC.

The Subcommittee met, pursuant to call, at 10:35 a.m. in room 2172, Rayburn House Office Building, Hon. James A. Leach, (Chairman of the Subcommittee) presiding.

Mr. LEACH. The Subcommittee will come to order.

On behalf of the Subcommittee, I would like to welcome our distinguished witnesses to the hearing this morning. We appreciate your willingness to come to make an earlier start to our proceedings today.

The purpose of our discussion this morning is to focus on developments in Japan and their impact on the United States and the broader Asia-Pacific region. At first blush this might seem an unusual subject for congressional interest at this time. After all, United States-Japan relations, widely understood here and across the Pacific to be critical to advancing peace and stability in Asia and the Pacific, are at “best-ever” levels.

The partnership between our two countries—based on a remarkable coincidence of interests economically, strategically, and in terms of shared democratic philosophy—continues to deepen and mature even as Japan itself adapts to the uncertainty of a post-Cold War world.

On the home front, Prime Minister Koizumi has promoted a series of structural reforms designed to reverse economic stagnation and political gridlock that hallmarked much of the last decade of the 1990s. Although change in Japan’s merchantilist orientation has been gradual, it is nonetheless striking how Tokyo has become far more welcoming of foreign direct investment, non-Japanese corporate management, and greater competition within its home market.

Japan’s transformation has been even more striking in national security affairs. Over the last decade Japan has slowly but steadily begun to transform both its institutions of governance and outlook on world affairs in ways that permit more cooperation with the United States, as well as a greater degree of activism in international security affairs. At the same time Japan is becoming ever more important advancing a panoply of American foreign policy interests around the globe, from supporting counterterrorism operations in the Indian Ocean, to contributions to humanitarian assistance in Iraq, to preventing the proliferation of weapons of mass

destruction, and to working with the United States and others in seeking a peaceful resolution of the North Korean nuclear challenge.

For many years Japan has also been deeply engaged with the United States and other industrialized democracies as a leader at the United Nations and other multilateral institutions. Indeed, the first article of the 1960 U.S.-Japanese Security Treaty includes the stipulation that both partners “will endeavor to strengthen the United Nations so that its mission of maintaining international peace and security may be discharged more effectively.”

In this regard, it is in the world’s interest and the United States national interest to expand the United Nations Security Council. From a congressional perspective, I find the claim of Japan—the world’s second largest economy, the largest creditor country, and a leader-donor foreign assistance—to be compelling. Japan’s candidacy deserves American’s unswerving support.

Having noted this, it should be understood that there are powerful secular trends driving policymakers in Japan and elsewhere in the region which demand America’s closest attention. For a variety of reasons, it would appear that power politics is on the rise in Northeast Asia with its attendant potential to great uncertainty and foster regional instability. Attentive American concern, continued engagement, and steady leadership is vital if peace and prosperity is to be preserved in this historic cockpit of geopolitical conflict.

In many cases, the causes of recent friction have little to do with the United States. They are more related to the past than to the present. Indeed, it is profound how history can be more controversial than current events. For example, while the Second World War, and the expansionism that preceded it in Asia is a past-tense phenomenon for short-memorized Americans, the first half of the 20th century lives far more vibrantly in the hearts and souls of millions of Chinese, Japanese and Koreans. A surprising level of antagonism has sprung up between South Korea and Japan over historical issues, including competing territorial claims for a chain of islets that lie between the two countries. Likewise, Sino-Japanese relations have deteriorated with the Chinese people reflecting anger at the possibility that Japan could become a permanent member of the U.N. Security Council, and the Japanese people becoming increasingly angry at Chinese attitudes both toward the past and competitive approaches to the future.

Here it is important to reflect upon the fact that at every turn in the last century the world has underestimated the power of nationalism. Events of the last several weeks remind us how impressive for good or ill, is that power, the desire of people to carve their own destiny, to make their own mistakes.

In this context, we have assembled a distinguished panel to address these and other issues.

Mr. Wilson, do you have an opening statement?

[The prepared statement of Mr. Leach follows:]

PREPARED STATEMENT OF THE HONORABLE JAMES A. LEACH, A REPRESENTATIVE IN
CONGRESS FROM THE STATE OF IOWA, AND CHAIRMAN, SUBCOMMITTEE ON ASIA AND
THE PACIFIC

On behalf of the Subcommittee, I would like to welcome our distinguished witnesses to our hearing this morning. We appreciate your willingness to accommodate an earlier start to our proceedings today.

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The partnership between our two great countries—based on a remarkable coincidence of interests economically, strategically, and in terms of shared democratic philosophy—continues to deepen and mature even as Japan itself adapts to the uncertainty of the post-Cold War world.

On the home front, Prime Minister Koizumi has promoted a series of structural reforms designed to reverse the economic stagnation and political gridlock that hallmarked much of the "lost decade" of the 1990s. Although change in Japan's mercantilist orientation has been gradual, it is nonetheless striking how Tokyo has become far more welcoming of foreign direct investment, non-Japanese corporate management, and greater competition within its home markets.

Japan's transformation has been even more striking in national security affairs. Over the last decade Japan has slowly but steadily begun to transform both its institutions of governance and outlook on world affairs in ways that permit more cooperation with the United States, as well as a greater degree of activism in international security affairs. At the same time, Japan is becoming ever more important to advancing a panoply of foreign policy interests largely consistent with American objectives: from supporting counter-terrorism operations in the Indian ocean, to contributing humanitarian assistance in Iraq, to preventing the proliferation of weapons of mass destruction, to working with the U.S. and others in seeking a peaceful resolution to the North Korean nuclear challenge.

For many years Japan has also been deeply engaged with the U.S. and other industrialized democracies as a leader at the United Nations and other multilateral institutions. Indeed, the first article of the 1960 U.S.-Japanese security treaty includes the stipulation that both partners "will endeavor . . . to strengthen the United Nations so that its mission of maintaining international peace and security may be discharged more effectively."

In this regard, it is in the world's interest and the U.S. national interest to expand the United Nations Security Council. From a Congressional perspective, I find the claim of Japan—the world's second largest economy, the largest creditor country, and a leading donor of foreign assistance—to be compelling. Japan's candidacy deserves America's unswerving support.

Having said all that, it should be understood that there are powerful secular trends driving policymakers in Japan and elsewhere in the region which demand America's closest attention.

For a variety of reasons, it would appear that power politics is on the rise in Northeast Asia, with its attendant potential to create uncertainty and foster regional instability. Attentive American concern, continued engagement, and steady leadership is vital if peace and prosperity is to be preserved in this historic cockpit of geopolitical conflict.

In many cases, the causes of recent friction have little to do with the United States. They are more related to the past than to the present. Indeed, it is profound how history can be more controversial than current events. For example, while the Second World War and the expansionism that preceded it in Asia is a past-tense phenomenon for short-memory Americans, the first half of the 20th century lives far more vibrantly in the hearts and souls of millions of Chinese, Japanese, and Koreans. A surprising level of antagonism has sprung up between South Korea and Japan over historical issues, including competing territorial claims for a chain of islets that lie between the two countries. Likewise, Sino-Japanese relations have deteriorated, with the Chinese people reflecting anger at the possibility Japan could become a permanent member of the UN Security Council, and the Japanese people becoming increasingly angry at Chinese attitudes both toward the past and competitive approaches to the future.

Here it is impressive to reflect upon the fact that at every turn in the last century the world has underestimated the power of nationalism. Events of the last several

weeks remind us how impressive, for good or ill, is that power, the desire of people to carve their own destiny, to make their own mistakes.

In this context, we have assembled a distinguished panel to address these and other issues. I look forward to your testimony.

Mr. WILSON. Thank you, Mr. Chairman, and thank you for your leadership in bringing focus on Japan, the long-term relationship that we have with Japan, our ally and our partner, and I know firsthand from my home State of South Carolina how much we appreciate the relationship that we have with Japan. We have welcomed significant investments in my home State.

American Koyo is located adjacent to the district that I represent. Fuji Film in Greenwood is one of the major employers. We are very pleased with Hatachi in Greenville, with Honda in Florence. In fact, another asset that we have, I am very grateful—I represent Hilton Head Island, and we have nearly 200 golf courses from Hilton Head Island to Charleston to Myrtle Beach.

And Mr. Chairman, we welcome Japanese tourists. We have found that it is actually less expensive to fly to South Carolina and play golf than play on some of the golf courses in Japan. And so we have an open door for visitors from Japan, and investments from Japan, and I am honored to be here, and thank you very much again for your leadership.

Mr. LEACH. Well, thank you.

Our witnesses today are Professor Thomas Berger who is an Associate Professor, Department of International Relations at Boston University. An author of regional security issues and a former Associate Professor of Johns Hopkins, Dr. Berger earned his Ph.D. from MIT.

Professor Leonard Schoppa is Associate Professor at the Department of Political Science at the University of Virginia, and the author of books on Japanese economics and social trends. Previous Director of the East Asia Center at the University of Virginia, Professor Schoppa was a Rhodes Scholar, Post-doctoral Fellow at Harvard, and a Fulbright Grantee.

Dr. Richard Katz is a Senior Editor of *The Oriental Economist Report*, as well as an Adjunct Professor at NYU, Stern School of Business. A veteran journalist and author, Mr. Katz has also served on the Council of Foreign Relations Task Force on the Japanese Economy.

Unless you have made arrangements separately, I will introduce you in the order that has been suggested, and without objection all of your statements will be placed fully in the record. And you may proceed as you see fit, preferably not longer than 5 to 7 minutes.

Dr. Berger.

Mr. BERGER. 5 to 7, all right.

Mr. LEACH. Right.

Mr. BERGER. All right. Well, I will do my best.

STATEMENT OF THOMAS U. BERGER, PH.D., ASSOCIATE PROFESSOR, DEPARTMENT OF INTERNATIONAL RELATIONS, BOSTON UNIVERSITY

Mr. BERGER. Let me begin by thanking the Committee for this opportunity to speak to you on this particular subject. And within 7 minutes, I see 8.53 on the counter here, let me just try to talk

briefly about this subject off of the testimony which I have given to you.

Now, there is a general consensus among Japanese security experts and observers of Japanese foreign policy that Japan is moving toward a much larger international security role, and it has been true of the past. This raises three pertinent questions.

First of all, how serious is Japan about becoming a military, a political-military power as well as a political economic power?

Second, what accounts for this trend and is it sustainable? Is it likely to continue in the future?

And third, what are the costs and the benefits of this development for United States interests and for the Asian region as a whole?

I think we in this room will all agree that Japan's strengthening of its alliance relationship with the United States is a very positive thing, but we also need to be sensitive to the costs, the potential costs of this development. And I am afraid, as the Chairman has already pointed out, some of those costs are very much in evidence on the streets of Seoul, Beijing and other major cities throughout the region.

How serious is the trend? Again very briefly, it depends really on how you look at it. I mean, in some ways the glass is half full as well as half empty. On the one hand, Japanese defense spending remains limited, about 1 percent of GDP. It is being reduced in some ways. The Japanese forces continue to operate under rather onerous restrictions regarding the use of force, and the United States-Japanese security alliance relationship remains a highly symmetrical one.

The United States is committed to coming to the aid of Japan in the event of an attack upon it. On the other hand, Japan, under current interpretation of Japanese law and of the Japanese Constitution, is likely to offer only logistical support if there is a crisis involving United States interests.

On the more positive side, we have to recognize Japan as very impressive, ARC and other military capabilities. It is in the process of reconfiguring its forces and re-equipping its forces so that they can play a larger international security role in the future, and there has been a general trend over the past decade toward further integrating Japan into the United States grand strategy, and this is reflected by a whole series of events which I do not need to go into.

In short, I think it is important to recognize that Japan remains a very long way from being an Asian equivalent of Great Britain. At the same time, however, it is certainly no longer just a sort of semi-passivist civilian power that it has been characterized as being for over half a century, and the general trajectory of recent years suggests that it is moving into an increasingly supportive role vis-a-vis the United States and international security stability in general.

Why is it doing so? Well, I think that in order to understand we need to take into account the basic Japanese calculation, strategic calculation that has guided its foreign policy for over half a century.

Japan is quite capable in theory of providing for its own security. However, Japanese governments and Japanese officials who have looked at this issue over the decades have come to the conclusion that were it to try to do so independently of its security relationship with the United States, this is likely to be, (A) costly economically; (B) politically unpopular at home; and (C) very provocative to its relationship to the region. It could prove a regional arms race, and therefore for Japan to try to go it alone is likely to undermine, not strengthen, Japanese security interests.

Therefore, Japanese policymakers have for decades felt inclined to look to the United States, to look to its security relation with the United States as a vehicle for its international security role.

Three things have changed now in recent years that have pushed Japan to become active.

First, the Japanese recognition that with the end of the Cold War they have to do more on burden-sharing issues if they are going to maintain the relationship with the United States.

Second of all, the domestic political forces—and Len Schoppa will, I think, speak to some of those—that historically have resisted Japan's launched critical role, have moderated their views. They have not disappeared, but they have become much more moderate.

And third and finally, Japan feels—and this is part negative as well as positive implications—Japan feels both threatened and isolated in the region, especially from North Korea and the People's Republic of China, and this sense of isolation is leading Japanese leaders to look again to the United States for support and reassurance.

All three of these changes are not temporary events. All three of them are likely to be, in my view, long lasting. They are, however, problems which need to be addressed and I will point to two of them.

The first problem which I would like to talk about is that there is a danger of a domestic/political backlash emerging at some point in the future about Japan's increased strategic integration with the United States. The Japanese public in general is tolerant but unenthusiastic about expanding Japan's security role. Even pro-Japanese defense analysts and political leaders worry that Japan, by becoming more integrated with the United States strategically, could be dragged into costly regional conflicts that do not serve its interests, problem number one.

Problem number two, and this is what again I think some of you have already indicated is of importance, Japan's increased defense role coincides with a sharp increase in nationalism, not only in Japan but also in China and in South Korea.

Now, these rising nationalist passions are focusing in particular on how these countries view their recent history in very different ways, and we can see that these conflicts over history, the so-called history problem, can be very damaging.

On Monday, the NKE dropped 3.8 percent. A variety of factors contributed to that, but certainly Japanese business concerns that its very large economic interest in China could be at risk as a result of these fights over history contributed to that sell-off.

There are also reasons to be worried that relatively small issues, issues that in theory should be manageable, such as questions

about where to delimit the Japanese versus Chinese exclusive economic zone, or questions pertaining to the Senkaku/Diaoyutai Islands which are disputed between Tokyo and Beijing, and Seoul, respectively. These kinds of issues can become more polarized, more tense, and they could lead to, unfortunately, much more serious and dangerous kinds of disputes and clashes in the future. So I think that these are problems that we need to pay attention to.

To briefly say what might we be able to do about these issues, with regard to the first issue I think United States needs to do two things.

First of all, it needs to demonstrate to the Japanese that their contribution to international security is not only appreciated here in Washington, but also bring substantive benefits to Japan, to Japanese national interests.

Examples of what we could and should be doing include United States support on clarification of the fate of the Japanese citizens abducted by North Korea. Another issue is United States support, which we are expressing, for Japan's bid for a permanent seat in the U.N. Security Council.

The other thing which we need to do is strengthen and expand the kind of mechanisms that we have for incorporating Japanese views into American policymaking in the strategic area. We are already doing this on the bilateral level in terms of strengthening, for example, the two-plus-two talks. We may eventually want to widen this to include other regional partners, democratic regional partners, including ideally countries like South Korea, Australia, New Zealand, and possibly the Southeast Asian countries.

With regard to the history, this is a much more difficult issue. The first problem is relatively well understood here in Washington, and we are trying to address it. The second problem, however, is relatively new for American policymakers. We have tried to avoid dealing with the history issue for some good reasons.

In the end, this is an issue which I think the Asian countries will need to sort out by themselves. Nonetheless I think tensions are getting to the point, and the blockage between the Asian capitals has reached a point where it is useful for the United States to indicate support for increased dialogue.

Leaders in Tokyo but also in Beijing and Seoul must indicate a willingness to support a dialogue, and that kind of dialogue should probably be taking place in a sort of Track 2, non-official or semi-official basis. And also, I mean, policymakers in these countries need to seriously consider implementing the kinds of policy recommendations that may emerge from that kind of dialogue. I can talk more about these issues later in the question and answer. But on the balance, despite these problems, I think that the positive aspects of what Japan is doing in the security field clearly outweigh the negative costs that I have just indicated. By strengthening its relations with the United States, Japan, I think, is successfully addressing the primary concern that policymakers in the United States and Tokyo faced only a decade ago. The concern, of course, stemming from the experience in the first L-4, and the first crisis in the Korean peninsula that in the event of a serious military clash, Japan might sit on its hands, and by doing so undermine its strategic relationship with the United States.

I think Japan is addressing that. If it can also address these problems which I have just mentioned successfully, I think that the two countries together are creating, to borrow some language from the 2002 national security strategy of the United States, “a balance of power that favors freedom” in the Asian region and perhaps beyond.

Thank you.

[The prepared statement of Mr. Berger follows:]

PREPARED STATEMENT OF THOMAS U. BERGER, PH.D., ASSOCIATE PROFESSOR,
DEPARTMENT OF INTERNATIONAL RELATIONS, BOSTON UNIVERSITY

There exists today a general consensus among security and foreign policy experts that the US-Japanese security relationship is the best it has ever been. Over the space of the past few years, Japan has increased substantially its role in international security while bolstering the US-Japanese alliance. The Japanese Self Defense Forces are performing a broader range of missions across a wider geographic area than ever, including offering logistical support for coalition naval forces in the Indian Ocean and assisting with the reconstruction of Iraq. Japanese diplomats and political leaders are coordinating their efforts with the United States highly sensitive security issues such as North Korea and the Taiwan Straits. And Japan is moving to further integrate itself with the United States in a number of different strategic areas, most notably with its decision to support the development and deployment of a Ballistic Missile Defense system in Asia.

As a result of these efforts, the primary danger that faced the U.S.-Japanese alliance only a decade ago—the danger that Japan would fail to respond to a regional crisis and thus undermine its relationship with the United States—has dissipated. At the same time, by strengthening its security relationship with the United States and participating in international peace keeping and reconstruction missions, Japan is making a substantial contribution to East Asian stability. There can be little doubt that it is in the interest of both nations that this trend be continued and reinforced.

This having been said, it is necessary to acknowledge that not everything is sunshine and light in Japan's new foreign policy stance. Some of the reasons for Japan's closer strategic relationship with the United States—namely its growing isolation from the rest of North East Asia—are not entirely positive. Differences remain between the United States and Japan on a number of important security issues, and there are other areas where serious difficulties could emerge. Two problem spots in particular stand out. First, there is a real danger of a domestic political backlash in Japan against its strategic integration with the United States. Such a backlash could undo much of the progress that has been made over the past decade.. Second, Japan's new international security role is feeding a trend towards increased nationalism not only in Japan, but in South Korea and the People's Republic of China as well. The conditions are ripe for a kind of “perfect storm” of nationalist passions, one that heightens tensions in the region and could turn what should be relatively minor disputes over territorial issues and symbolic issues into full blown crises.

The Long March towards a true Alliance

To appreciate how far the U.S.-Japanese alliance has come, as well as how far it could still go, it is worth briefly reviewing the overall trajectory of the relationship since its inception. Four phases are identifiable

In the beginning, the standard line was that the Mutual Security Treaty was something of a misnomer: it was not at all mutual; it was only partially secure; and many observers felt it was not even much of a Treaty. Established at the end of the US occupation, it was essentially a US security guarantee in return for Japanese alignment in the Cold War and the provision of military bases. Faced with only a minimal direct security threat from the Communist powers, Japan was fearful of becoming overly entangled in potentially costly conflicts in Asia (Korea, Vietnam). As a result, it restricted the degree to which its fledgling Self Defense Forces cooperated with their counterparts in the U.S. military. The United States, for its part, was forced to content itself with denying Japan's substantial industrial resources to the Communist powers and relied on its bases in Japan to help contain Communism in the Far East. Despite repeated US efforts to get the Japanese to play a larger role, there was little formal military-to-military contact between the two sides and relatively little coordination on broader strategic military issues,.

In the late 1970s and the first half of the 1990s this state of affairs changed as a result of a massive Soviet military build up in the Far East. Faced with the emergence of a serious Soviet threat to Japan's vital sea lines of communication and to the northern island of Hokkaido, Japan embarked on a significant upgrading its force structures and intensified its military ties to the United States. The centerpiece of this new relationship was the 1978 Guidelines on US-Japanese Defense cooperation, which allowed the Japanese Self Defense Forces to plan and train together with US military forces. Nonetheless, Japan continued to allocate only a fraction of its resources to military defense (approximately 1% of GDP) and cooperation with the United States remained strictly limited to the defense of Japan.

After the Cold War, many in Japan briefly hoped that it would become less reliant on the United States for its security, possibly through the creation of an Asian multilateral security regimes. These hopes were soon dispelled by a series of crises: the first Gulf War in 1990–1991, the first Korean nuclear crisis in 1994 and the 1996 crisis in the Taiwan Straits. In response, Japan expanded its international military activities, allowing the JSDF to participate in international peace keeping operations and by refurbishing its security relationship with the United States. Essentially, Japan indicated that it was willing to provide logistical and other forms of support to US military operations on a regional basis.

9/11 led to a dramatic expansion of the geographical scope of Japanese support for the United States. Determined to avoid a repeat of Japan's failure to act in the first Gulf War, the Koizumi government moved with remarkable alacrity to dispatch Japanese naval forces to the Indian Ocean (where they provided as much as 50% of the fuel used by coalition naval forces backing US operations in Afghanistan) and, later, to deploy 600 Ground Self Defense Forces to assist in the reconstruction of Iraq. Japan also indicated that it was willing to participate in a BMD system in East Asia, a step that promises to further significantly integrate Japan's intelligence and command and control functions with those of the United States.

Underlying the post Cold War shift in Japanese policy has been the basic calculation that the U.S.-Japanese security treaty relationship continues to serve vital Japanese national interests. Japan recognizes that in Asia, unlike in Western Europe, there remain many serious potential security threats even after the old Soviet threat has receded. In theory, Japan has the wherewithal to provide for its own security. With the world's second largest economy, an abundance of skilled scientists and engineers, and large, highly sophisticated military, aerospace and nuclear power industries, Japan could—if it so desired—field in a relatively short period of time (less than five years) the most formidable military in East Asia, replete with a very substantial nuclear arsenal. However, the Japanese government believes that doing so will a) cost a great deal economically, b) increase regional tensions, c) damage its relations with the United States and thus d) make Japan less, not more secure. Reliance on the United States seems much the preferable option. To maintain the relationship, however, Japanese leaders appreciate that more will have to be done in the future than during the Cold War.

Japan still remains a long way from being the Britain of the Far East that many analysts have hoped it would become. The Japanese public remains instinctively suspicious of the military both as an institution and as an instrument of foreign policy. In addition, there remains a fundamental fear in many quarters of entanglement, that if the Japanese armed forces become overly integrated into American strategy they may drag Japan into costly struggles that do not serve Japanese national interest. The Japanese Self Defense forces legally are prohibited from engaging in combat except in the defense of Japan. To this day, the US-Japanese relationship remains a highly asymmetrical one insofar as the United States is committed to the defense of Japan while, under the current interpretation of its constitution, Japan is prohibited from coming to the aid of the US if it is attacked.

This being said, the changes in Japan's security role are impressive and are likely to continue in the future, even after the probable departure of the notably pro-defense Prime Minister Koizumi. There are two reasons for this relatively optimistic prognosis: Changes that have occurred in Japanese domestic politics and rising tensions with its Asian neighbors.

As to the first, the domestic forces that traditionally opposed an expansion of Japan's military role, the old Japanese left centered on the Socialist and Communist parties, have essentially evaporated. While the preference for a non-military "soft power" approach remains strong, especially in the Democratic Party of Japan and in the LDP's coalition partners (the Clean Government Party) Japan today is far more ready to countenance the use of the military than was true only a decade ago. Inside the Democratic Party there are many security realists who are likely to support the continuation of current policies (with some modifications).

Second, Japan's growing isolation in North East Asia is creating a deep sense of unease in Tokyo and is propelling Japanese leaders to look to the United States for support and reassurance. First and foremost on the list of Tokyo's strategic concerns is the threat emanating from North Korea. Korea's repeated missile tests, especially the 1998 launch of the Taepodong missile, as well as evidence of North Korean espionage operations inside Japan, demonstrates the existence of a capacity to threaten Japan. Repeated hostile statements, including Pyongyang's September 2004 threat to turn Japan into "a sea of fire" demonstrate its hostile intent. The much publicized plight of Japanese citizens who have been abducted by North Korean agents, as well the numerous reports in the Japanese media concerning the immense suffering of the North Korean people, has underlined the malignant nature of the Pyongyang regime. For ordinary Japanese, evil now has a human face: the face of Kim Song Il.

Perhaps even more disturbing to Japan are the growing tensions with the People's Republic of China. Although the two nations are more integrated economically than ever, and share common interests across a broad range of issues, on a fundamental level, neither side trusts or likes the other. China fears Japan's potential military power and is convinced that its professions of pacifism are a sham. Japan for its part is alarmed by China's growing military capabilities and is alienated by the rising tide of anti-Japanese nationalistic sentiments. A number of factors exacerbate these tensions. They include differences over territorial issues (the Senkaku/Diaoyutai island and the demarcation of Japan's and China's exclusive economic zones in the Sea of Japan); the growing competition between Beijing and Tokyo for energy resources; and perhaps most volatile of all, differences over how the two countries view recent Asian history. As a result, the mood in Tokyo has become dramatically more hostile towards China over the past decade, leading to the slashing of Japanese foreign aid to the PRC and a willingness to confront Beijing over sensitive issues such as Taiwan and Yasukuni.

Despite these newly intensifying threats, in the end Japan remains reluctant to commit itself fully to a confrontational course with its Asian neighbors. WMD proliferation and counter terrorism remain a lower priority for Tokyo than for Washington. In the event of an outbreak of hostilities on the Korean peninsula, Japan is far more vulnerable to North Korean retaliation than is the United States. Japan is therefore more likely to prefer a diplomatic solution to the crises, and less willing than the US is to contemplate options that could lead to military escalation.

In the same vein, Japan realizes that in the long run it will need to accommodate itself to a rising Chinese superpower. While from an American point of view China may become a potential challenger, for Japan it is also an inescapable neighbor. Many Japanese believe that a weak, insecure and unstable China could pose an even more problems than a strong and assertive one. Japan's preferred solution for dealing with China is to engage it economically and politically in order to eventually integrate it into the international system as a peaceful, prosperous, status quo oriented power.

At the same time, Japan is less convinced than it was a decade ago that engagement with China will bring about a positive transformation any time soon. While Japan will continue to pursue a policy aimed at strengthening multilateral security institutions at both the regional and global levels, such efforts will remain subordinate to Japan's over-riding interest in maintaining and strengthening the alliance relationship with the United States. Eventually, most Japanese continue to hope that a combination of allied firmness together with a growing network of economic, cultural and political ties with its neighbors will bring about a more relaxed atmosphere in the region. This, however, is likely to be a task that will require not years but decades to come to fruition.

Storm Clouds

In the near future, however, there are two serious strategic problems confronting Japan and the United States today that need to be addressed.

First, there exists the serious danger that at some point a domestic political backlash will emerge against the recent trend towards Japan's strategic integration with the United States. While Japanese public opinion has so far been tolerant of recent shifts in Japanese defense policy, this could quickly change if Japan's new overseas commitments turn out to be costly ones. There is a general fear in the Japanese public that Japan is easily manipulated by the United States. Even many pro-defense Japanese policy makers worry that their relationship with the United States is too one sided.

To ameliorate these concerns it is necessary to do three things. First, the United States needs to take steps that demonstrate that the United States is respectful of Japanese interests. The recent US insistence that Japan be included in the six

power talks with North Korea, as well as expressions of US support for Japan's bid for a permanent seat on the Security Council are excellent examples of the kind of things the US can, and should continue to do in the future. Second, the United States will need to be cautious about the type of missions it pushes Japan to accept. While the Iraq mission has been relatively successful, there remains the danger that Japan's involvement in such operations may lead to significant Japanese losses. If those losses seem to have been incurred purely for American, not Japanese, interests, the domestic repercussions may be severe. The example of the impact of the Madrid bombings on the Aznar government offers a sobering example of the kinds of problems that could develop. Finally, mechanisms must be created that demonstrate that Japanese interests carry weight in American strategic decision making. Current, bilateral efforts, such as the "two plus two" talks, are a good first step. In the long run, the creation of broader multilateral frameworks, including other American democratic allies in the region, would lend greater legitimacy to Japan's expanded international security role. Unfortunately, at the current point in time, the prospects for creating such mechanisms are rather bleak.

The second major problem is that Japan's new defense activism is generating tensions in its relations with China and South Korea. These tensions have become increasingly evident in the flare up of Chinese and South Korean sentiments regarding Japan's supposed unwillingness to confront the history of Japanese Imperial aggression in the first half of the twentieth century.. In reality, over the course of the past decade, Tokyo has made some serious efforts to reconcile itself with its neighbors over the so-called "history issue." Japanese leaders from Prime Minister Hosokawa in the early 1990s on have offered apologies for the conduct of Japanese Imperial forces in Asia. The Japanese government, working with civil society groups, has tried to identify, apologize to and offer compensation to former Asian and European Comfort Women (over five hundred have in fact been so compensated). The large majority of Japanese high school and even middle school textbooks, carry references to the history of Japanese atrocities and aggression in Asia. In short, the notion that Japan suffers from sort of "historical amnesia" is a myth.

At the same time, it has to be acknowledged that Japan's efforts at coming clean on the "history issue" have been undercut by a vocal and politically influential right wing. The Japanese Right challenges what it sees as a "self-flagellating" approach to national history and has lobbied vigorously for the promotion of a healthy sense of patriotism. There has been a historical tendency for the Japanese Right to promote its views at times when Japan moves to expand its international security role. Many in the Koizumi government are sympathetic to the right-wing, and Koizumi himself has made a point of promoting Japanese patriotism by repeatedly visiting the Yasukuni shrine, dedicated to the two and half million Japanese soldiers and sailors who have died fighting modern Japan's many wars. In this sense, Japan's new defense role is linked to the emergence of a new Japanese nationalism.

This new Japanese nationalism, however, remains a far cry from its prewar counterpart. For the most part, its impact on the Japanese populace as a whole is relatively limited, and it is certainly not linked to an aggressive assertion of Japanese interest abroad. Instead, it is a rather defensive, "Japan should stand tall" sort of national pride. Unfortunately, it is coming at a time when domestic political factors are spurring populist forces in both China and South Korea. Combined with the apprehensions over Japan's new international security role, the conditions are set for a prolonged period of heightened tensions in the region. There is a very real possibility that things can get out of hand, possibly as a result of violence against innocent Japanese or Chinese citizens residing in each others countries. The economic damage that even the limited unrest seen so far can inflict is considerable. Down the line, more serious, militarized confrontations are not entirely implausible.

Defusing this problem is likely to be a difficult, long-lasting process. Domestic political sensitivities are high on all sides. Moreover, after more than a decade of unsuccessful grappling with the issue of Japanese war guilt, a mood of apology fatigue has set in in Tokyo. Nonetheless, Japan as well as China and South Korea should be encouraged to come to terms with the issue by embarking on an intensified dialogue. The best forum for such a dialogue would be through so-called "Track II" channels where government officials together with scholars and representatives from civil society groups coe together on a bilateral basis (Korean-Japanese and Chinese-Japanese basis) to discuss these issues and draft concrete proposals for policy makers. While the United States should not necessarily be a party in of such talks,. American and other foreign representatives could play a useful mediating role in such meetings and offer "best practice" advice drawn from a wide range of other cases dealing with reconciliation on historical issues.

Conclusions

The good news from Asia is that Japan is at last getting serious about creating a more balanced alliance relationship. Active Japanese participation in international security affairs can go a long way in alleviating American concerns about burden sharing and help maintain a balance of power that favors the spread of peace and prosperity in the Asian region. The bad news is that in so doing Japan inadvertently is sparking an upsurge in nationalist sentiment and acrimony in the region. On balance, the positive implications of this development outweigh the negative ones. Certainly this is true from the narrow perspective of the US-Japanese alliance. If concerns outlined above are addressed, it should be true from a general Asian point of view as well.

Mr. LEACH. Thank you very much. That was a very thoughtful statement.

Dr. Schoppa.

**STATEMENT OF LEONARD SCHOPPA, JR., PH.D., ASSOCIATE
PROFESSOR, DEPARTMENT OF GOVERNMENT AND FOREIGN
AFFAIRS, UNIVERSITY OF VIRGINIA**

Mr. SCHOPPA. Thank you. Thank you, Mr. Chairman and Members of the Committee for this opportunity to speak to you about a changing Japan.

I want to start by applauding the Committee for holding a hearing on our relations with Japan at a time when our relations with that country are remarkably stable. I think there is a tendency in our political relationship—our foreign policy to pay attention to countries only when there is a crisis, and there certainly is not one in our relations with Japan.

President Bush has a very cordial relationship with Prime Minister Koizumi. Our trade relations, which used to be very rocky, are relatively stable, aside from the issue of beef, and even the issue of Japan's financial crisis, which was the reason I believe for the last time this Committee held a hearing on relations with Japan, are relatively stabilized and that problem too is under control.

Nevertheless, because there are some long-term trends that could affect the United States' relationship with Japan, it is well worth our time to see where those trends are going and how we can best deal with them.

I would like to talk about three different trends today. The first is the decline of LDP. As you all know, the Liberal Democratic Party had a stable hold on power from 1955 to 1993. It ruled the country alone. Our close relationship with Japan during that time was reinforced by the LDP's stable hold on power, and our close relationship with many of the members of that party contributed to the stability and the maturation of our relationship.

Since the party split in 1993, however, the LDP has been unable to win a majority in any of the elections that have been held in 1993, 1996, 2000 or 2003. The fact that the LDP has found partners that have allowed it to supply the prime minister for the last decade might lead us to be tempted to think that LDP is back with a stable hold on power, and that, I am going to argue, would be mistaken. And so we should pay attention to this.

A particular reason for thinking about this question is the scenario that we want to avoid, which has played out in our relationship with South Korea. In that country, our long-time close relationship with the politicians who are in the Grand National Party has come under strain as that party has been pushed into the mi-

nority, and the new President Roh and his Uri Party seem to have very different attitudes toward a relationship with the United States, toward China, and even toward how to deal with North Korea.

We should be cognizant of what is happening to the LDP so that we are not caught by surprise and are not forced to deal with a new group of people that we have no idea how to deal with.

Is the LDP really in trouble? If you look at some of the opinion pool data that I supplied in my testimony, you will see that Koizumi has maintained a remarkable degree of popularity, much more popular than his predecessors as prime minister. At one point his popularity rating was 80 percent for some months in 2001, and he has held onto the popular rating of around 40 percent lately.

He has been able to use his popularity to promote a relatively controversial agenda calling for structural reform, reduced government spending on public works, and postal privatization.

Despite this popularity of Koizumi himself, we should not overlook the fact that the LDP has continued to lose support. Its popularity ratings have lately hovered around 30 percent. In the Upper House election last summer, the LDP won fewer votes than the opposition Democratic Party of Japan, the DPJ.

The LDP did best among voters over 70. Among voters 60 and younger, the Democratic Party of Japan was more successful. So given the fact that the population over 70 is gradually passing away, and the rural voters, who are the other support base for the party, is also shrinking, the LDP is going to continue to struggle to hold onto power.

This is a particular problem because Prime Minister Koizumi is term limited. The Liberal Democratic Party has rules of its own which limit him to having to step aside in the year 2006, so they will have to go into the next election, which has to be held by 2007, under a new leader. And it is very possible that this new leader will be much less popular than Mr. Koizumi, and the party may even choose someone who made his name opposing Mr. Koizumi, and this could contribute to a further decline in the party.

The way the United States, I think, needs to anticipate this possible development is to make sure that it is maintaining a cordial relations with the opposition Democratic Party of Japan, and to appreciate that this relatively new opposition party is quite different from the old Socialist Party of Japan, which used to be the main opposition party.

The current leader of the DPJ, Okada Katsuya, is a very moderate figure. He began his career as a member of the Ministry of International Trade and Industry, as a bureaucrat. He is from a prominent business family. He holds middle-of-the-road views on economic and security issues. He is someone we can work with. We should not have to deal with the kind of situation that has arisen in our relationship with South Korea if we make adequate preparations.

The second trend I want to talk about is the recent surge in nationalist rhetoric in East Asia. As Mr. Berger just pointed out, we have recently had a series of anti-Japanese demonstrations in China. A similar event took place last summer over a soccer match. At that time as well there were bottles thrown at the Japanese

bus, and chants of “kill, kill, kill” from the stands by the Chinese fans aimed at the Japanese.

As a Chinese official undiplomatically pointed out, the anti-Japanese sentiment in China is at least in part a result of Japanese actions. The Japanese military did commit atrocities during the war, and Japanese politicians and textbook regulators have repeatedly aggravated war memories through words and actions that have convinced Asian neighbors that the Japanese have not fully owned up to what they did. That does not justify Chinese behavior in any way, but it does suggest that both sides need to take actions to ameliorate the situation.

So the danger that I think we need to be aware of is that some Japanese politicians may be tempted to play to the crowd. The Japanese public is certainly reacting to what is happening in China, and we have the example of an up-and-coming LDP leader, Abe Shinzo, who became very popular by taking a very aggressive stand toward North Korea over the last several years.

It is possible that Mr. Abe or some other LDP politician might try to do the same by taking an aggressive attitude toward China. That would certainly aggravate the situation, and we need to be aware in our diplomacy and our conversations with the Japanese to discourage any kind of strategy of that kind.

A final background to this is in the second chart that I supplied in my testimony which shows public opinion toward China over the last 25 years. What it shows is that China, starting in the 1970s, was very popular with the Japanese. They considered it a close friend. After Tiananmen Square, their attitude became more neutral, roughly evenly divided as to whether they considered China a friend or not a friend.

Over the last year we have seen a second sharp decline in the popular opinion toward China. Again, this could encourage Japanese politicians to take a very strong nationalist line toward China, and that would be something contrary to Japan’s interests as well as ours.

And the final trend that I talk about in my prepared testimony—I will not speak as much about it because I believe Mr. Katz will address much of this—is the trends in Japan’s fiscal situation and its demographic situation.

Japan combines a very unfortunate combination of an extremely unbalanced budget, running annual deficits of 6 to 7 percent of GDP, adding to a huge public debt level of gross debt of 160 percent at a time when it is facing rapid aging and a need to pay for pension and health care for these elderly people.

What this means for Japanese politics is that it is going to be very unstable. Japanese politicians, whatever party is in charge, are going to have to propose tax increases and benefit cuts. They are going to be playing a zero-sum game as far as the budget is concerned. It would be very tempting for opposition parties to criticize efforts to take a pro-active stance in dealing with these difficult fiscal issues. It could delay very necessary fiscal reforms in Japan.

The other possibility we should also be aware of is if a group of politicians come in and cut the budget too aggressively, it could contribute to a slow down in the Japanese economy that would also

be contrary to American interests. So we need to pay close attention to how Japanese politics could cause some whip-saw effects in Japanese fiscal policy, and how the United States might, through our diplomacy, help steer the Japanese toward a moderate, slow, constructive effort to deal with their budget deficit.

Thank you.

[The prepared statement of Mr. Schoppa follows:]

PREPARED STATEMENT OF LEONARD SCHOPPA, JR., PH.D., ASSOCIATE PROFESSOR,
DEPARTMENT OF GOVERNMENT AND FOREIGN AFFAIRS, UNIVERSITY OF VIRGINIA

Amidst recent tensions in the United States' relations with China over the Anti-Secession Law and with South Korea over how to deal with the North Korean threat, our relations with Japan stand out as a rock of stability. President Bush and Prime Minister Koizumi have enjoyed a cordial relationship that has grown closer in the period since Japan decided to commit troops to Iraq. The trade wars that used to cause us difficulty appear to be behind us (with the exception of beef after the BSE scare). Even Japan's banking crisis, which was a major concern several years ago when it was in danger of destabilizing global financial markets, is finally under control. Given the tendency of our political system to pay attention to foreign countries only when there is a crisis, I must applaud this subcommittee for deciding to take a *proactive* look at "a changing Japan" at a time when there are few readily apparent signs of trouble. The goal, I assume, is to identify emerging trends that might cause us trouble in the future. In my testimony today, I'd like to focus on three trends related to domestic politics that we should be watching closely.

The first trend is the decline of the Liberal Democratic Party (LDP). As most of you know, the LDP governed Japan continuously and with complete control over all cabinet seats from 1955 to 1993—a continuity in power that contributed greatly to the stability and maturation of the U.S.-Japan alliance. Since a group of LDP members split off from the party in the summer of 1993, however, the LDP has been *unable* to win a majority of seats in the Lower House of the Diet. In elections held in 1993, 1996, 2000, and 2003, the party won the largest number of seats, but in each case it fell short of being able to rule on its own. The fact that the LDP has found partners that have made it part of the ruling coalition since 1994 and that the party has supplied the prime minister since 1996 should not obscure the fact that the LDP is a party with a shrinking voting base and that it could easily cede power to a rival coalition before or after elections that are due to be held by the summer of 2007.

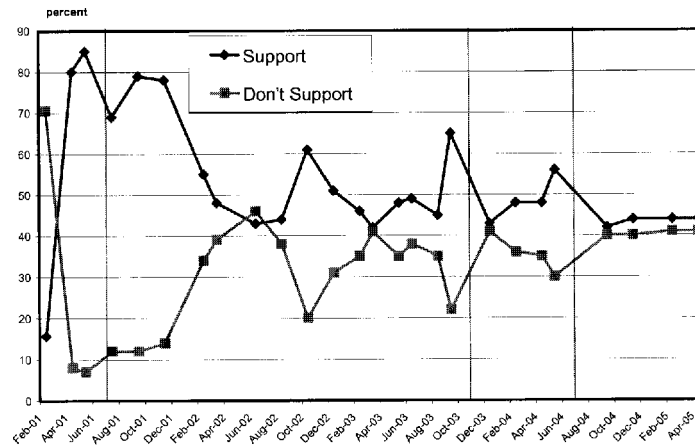
The scenario we all want to avoid, I think it's fair to say, is the one that has played out in our relations with South Korea as our long-time partners in the bilateral alliance in the Grand National Party have been pushed into the minority there by President Roh Moo Hyun and his supporters in the Uri Party. Both the president and leading figures in this party seem to have a very different attitude toward the US-Korea Alliance than the politicians we were accustomed to working with in the past; they appear not to share our apprehensions about developments in North Korea; and they appear to be much friendlier toward China than are members of the GNP. This experience in our relations with South Korea suggests we should be paying close attention to how the LDP is faring in its efforts to avoid being ousted from power—and that we should be preparing for the day when a new generation of politicians, perhaps from the current opposition parties, come to power.

Is the LDP really in trouble? Koizumi's ability to hold onto his office for four years, earning popularity ratings that at times exceeded 80 percent, might seem to suggest that the old predominant LDP is back. Such a conclusion would be wrong. Koizumi earned his highest popularity ratings early in his tenure (see the figure below) after he won the office in an internal LDP contest *against* the party's old guard: the Hashimoto Faction. He pledged to change the LDP, and the Japanese public cheered. He called for cuts in public works spending in the face of opposition from leading figures in his own party, and his popularity ratings soared.

Four years later, few are cheering. Koizumi has been able to trim pork barrel spending slightly, but Japan still spends a much larger share of its income on public works than other industrialized nations. The Prime Minister lost high profile battles to put the breaks on new highway construction and stop the flow of postal savings funds into money-losing public corporations. He is currently fighting one last battle to privatize the postal services (including postal savings), but few believe that these reforms will staunch the flow of fiscal red ink that has caused Japan's public debt to exceed 160 percent of GDP.

Koizumi's failure to deliver on his pledge to reform the LDP leaves the party extremely vulnerable. While the prime minister's support ratings have been consistently above 40 percent, the LDP's ratings have hovered near 30 percent. At the Upper House elections last summer, the party won fewer proportional representation votes than the Democratic Party of Japan (DPJ). The LDP did best among voters over 70 and in the most rural areas. The DPJ was stronger than the LDP among younger voters (those under 60) and in urban areas. With the cohort of voters over 70 gradually passing away and rural areas losing population, the LDP is likely to win even fewer votes at the next election—especially since the LDP's term limit rules (which bar Koizumi from seeking reelection as party leader in 2006) will force the party to face the voters without the leader that helped them boost their popularity in recent years. The party will do especially badly if it goes into this election with one of the next generation leaders that made his name opposing Koizumi (KOGA Makoto or ASO Tarō).

Koizumi Cabinet Support Rates, 2001-2005



Source: Nihon Keizai Shimbun public opinion surveys; vertical lines indicate the dates of general elections: for the Upper House in July 2001, for the Lower House in November 2003, and the Upper House in July 2004.

This prognosis suggests the United States should not let the warm relationship between Bush and Koizumi or concerns about the DPJ's position on the Iraq deployment keep it from cultivating relations with leading politicians from outside the LDP. The good news is that the Democratic Party of Japan, unlike the old Japan Socialist Party, is quite comfortable with the U.S.-Japan Alliance. OKADA Katsuya, the current leader, is a former Ministry of International Trade and Industry official from a prominent business family whose middle of the road views on economic and security issues should not worry the United States. One factor that has made our relations with young Uri Party politicians in South Korea difficult is their perception that we favored the conservative establishment for too many years. We can avoid this outcome in Japan by being careful to keep good relations with the opposition and by preparing to work with DPJ leaders should they come to power. A final related point: we should also be watching closely how Komeito, the LDP's partner in the ruling coalition, reacts to the LDP's declining popularity, since this centrist party with close ties to a Buddhist religious group could accelerate a change in power by switching sides.

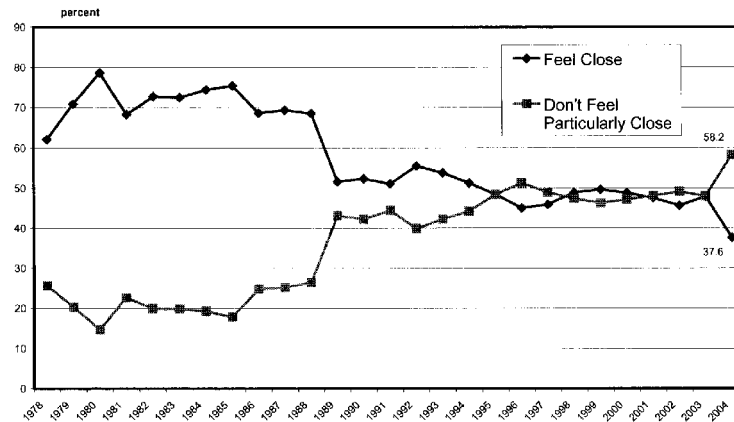
The second trend to watch, with implications for domestic politics, is the surge in "nationalist" rhetoric across East Asia. This past week we witnessed an outpouring of such sentiment in China, with violent anti-Japanese demonstrations sparked by the Japanese government's decision to approve history textbooks that do not fully describe atrocities committed by the Japanese military during the Pacific War. A year ago, Japanese were shocked by similar displays of Chinese animosity during the Asian Cup soccer tournament when fans threw bottles at the Japanese team's bus and fans chanted "kill, kill, kill" at Japanese fans during the match. As a Chinese official undiplomatically pointed out, the anti-Japanese sentiment in China is at least in part a result of Japanese actions. The Japanese military did commit atrocities during the war, and Japanese politicians and textbook regulators

have repeatedly aggravated war memories through words and actions that have convinced Asian neighbors that the Japanese have not fully owned up to what they did. That does not justify Chinese behavior in any way, but it does suggest that both sides need to take actions that ameliorate the situation.

The danger is that Japanese politicians will instead seek to boost their popularity at home by engaging in nationalist rhetoric of their own. Already ABE Shinzō, another contender in the race to succeed Koizumi, has shown how this can be done by taking a hard line with the North Koreans on the issue of abductees. The high profile he took in the negotiations has done little to improve relations with North Korea or resolve any of the difficult issues involved, but he did boost his popularity ratings. Koizumi has similarly played to the home crowd with his refusal to budge in his insistence on visiting Yasukuni Shrine where war-dead, including Class A war criminals, are interred. The visits to Yasukuni are an important reason why so many Chinese and Koreans have been upset with Japan lately.

Japanese politicians are likely to face even greater temptations to engage in such behavior in the coming years because the attitude of the Japanese public toward China has been steadily shifting (see the figure below). When Japan first normalized relations with China in the 1970s, most Japanese “felt close” to China. That attitude changed toward a more neutral position after the Tiananmen Square incident in 1989 and never really recovered during the 1990s. The incident involving the soccer team, combined with the steady rise of China’s economic power, seems to have led to another shift in the most recent poll last October. The proportion of the public that “doesn’t feel particularly close to China” (shitashimi o kanjinai) is now 58.2 percent, still short of the 78 percent who feel that way toward Russia but approaching that number. If incidents like those last week continue, it is easy to imagine that Japanese politicians could be tempted to play to these sentiments by turning up the volume of their own nationalist rhetoric.

Japanese Feelings Toward China



Source: Cabinet Office, *Gaiko ni kansuru yoron chosa*, October 2004.

This situation is of utmost concern to the United States since Japan and China are two of our leading trading partners and two of the most powerful countries in the world. It may seem tempting to some inside-the-Beltway analysts to egg on this conflict in order to bind Japan to us in the coming struggle to contain Chinese power, but that would be a grave mistake. The danger is that hostile relations between Japan and China (and between Japan and North Korea) will make our efforts to resolve disputes in this region more difficult, and perhaps impossible. It has been hard enough for Japan to gradually expand its security role within the alliance. In a climate of excited nationalism on the part of Asian publics, it will become impossible for Japan to continue moves in this direction without aggravating relations with all of its neighbors. Our job of maintaining alliances and encouraging the peaceful resolution of conflicts in this region will be much easier if we can encourage Japanese politicians to deal calmly with provocative incidents and take steps to mend relations with their Asian neighbors.

The final pair of trends that need to be watched are the nation's mounting public debt at a time when it faces a rapid aging of the population. Japan now has the oldest population profile in the world, and the society is continuing to age rapidly. By 2025, 29 percent of Japanese will be over 65. Compounding the difficult fiscal challenges Japan faces because of the rapid pace of its aging is the fact that the nation has wracked up gross public debt equal to 160 percent of its GDP and is adding about 7 percentage points to this figure every year. Given the difficulty *our* nation is having dealing with a Social Security "crisis" that is minimal in comparison to the challenge Japan faces, you don't need me to tell you that it will be a monumental task for Japanese politicians to adopt the benefit cuts and tax increases needed to deal with this situation. A measure of this challenge is the reaction of Japanese voters to the government's attempt to patch up their pension system last spring. Koizumi pushed through legislation that will increase pension premiums by *five percentage points* over the next ten years, while also trimming benefits. Just after these changes were adopted, however, the government announced that the fertility rate had dipped even lower than projected—a development that suggests additional benefit cuts and tax increases will be required in the future. The public also learned that the legislation just adopted included provisions for an infusion of general revenue into the National Pension System that will have to come out of unspecified *additional* tax increases in the future. Japan's voters therefore have continued to worry about whether the pension system will be there when they need it, and they took their frustration out on the LDP at the Upper House elections last summer.

How exactly Japan addresses its debt and demographic problems is not a major concern for the United States, but it is important to us that they figure out some way to *slowly* bring their books into balance while adopting structural reforms that allow the private economy to offset the drag of fiscal restraint with vibrant productivity growth. The first danger we want to avoid is the possibility that the difficulties of raising taxes and cutting spending lead the nation to postpone confronting its public debt problem until it is in such dire shape that high rates of inflation become the only way to make the debt go away. Such a fiscal crisis, in the nation that is the source of much of the world's capital (including much of the capital that finances our own deficits), would have major effects on the United States economy. Despite Koizumi's efforts to remake the LDP into a party of fiscal rectitude, recent setbacks in his efforts to push through his legislative program suggest that the post-Koizumi LDP will continue to be prone to postponing difficult economic decisions as long as possible.

At the same time, we want to avoid seeing fiscal reconstruction proceed quickly without structural reforms designed to unleash productivity growth and stimulate the economy. A Japan that *shrinks* during its period of fiscal consolidation—perhaps coinciding with our own period of "rebalancing" after running up deficits here—will serve as a major drag on global economic growth. We need Japan to do its part to serve as an engine of the world economy so that we avoid problems of recession, debt crises, and associated social turmoil in volatile regions of the world. This prospect might be something we have to worry about if the DPJ comes to power on a platform of fiscal reconstruction since that party's ties to the unions have made it hard for it to support deregulation and labor market reforms needed to make the economy more productive.

The good news is that what we want for Japan should be exactly what the Japanese want. What we need to do is to use our influence, through summit meetings and global economic meetings, to pressure Japanese politicians to strike the balance between deficit reduction and structural reforms that keep the economy growing steadily. My conclusion here about the correspondence of interests between Japanese interests and our own applies to the other two areas I discussed as well. Both Japan and the United States have an interest in preventing an escalation of tensions between China and Japan. We have an interest in maintaining our alliance, regardless of which political party is in charge. If the Congress and the executive branch avoid the danger of *neglecting* this important relationship, it should be easy for us to continue to count on it as a rock in an unstable region.

Mr. LEACH. Thank you very much, Dr. Schoppa.
Mr. Katz.

**STATEMENT OF MR. RICHARD B. KATZ, SENIOR EDITOR, THE
ORIENTAL ECONOMIST REPORT, TOYO KEIZAI AMERICA**

Mr. KATZ. Thank you for inviting us to this hearing and thank you for holding the hearing.

What I would like to do is go through some of the economic trends in Japan that I think could raise issues that will eventually appear before you as things you may have to deal with, and in many cases those do not directly involve bilateral United States-Japan relations, but rather the impact on the United States of things that occur in the Asian region. So some of the trends I think bear watching.

First of all, one is that Japan has gained an awful lot of financial stability. I think many of the fears that Japan was going to have a financial meltdown in the banking system or a financial meltdown in government bonds were overblown. They have an awful lot of safety valves, and so the idea there will be a financial crisis flowing out of Japan affecting global issues, global finance, was exaggerated.

The main impact, I think, was on Japan's own ability to grow. Nonetheless, that was a real risk, and I think what we have seen—even if it was a small risk—is that risk to the extent it exists has been greatly reduced which means two things: One is that it will have a financial meltdown. The risk of that has been reduced, but also Japan's ability to grow has improved. For 5 years, from 1997 through 2002, Japan experienced actually zero growth, and by some accounts, slightly negative. So by reducing the nonperforming loans, strengthening the banking system, they have gotten out of that kind of malays.

But I do not think that the financial situation is quite as strong as some people suggest. For one thing, the banks themselves are stronger, but that does not necessarily imply that the borrowers are stronger.

If you look on the chart, for example, on page 9, what you will see is that one of the reasons why nonperforming loans are down is that it is easier to perform on your loans if you have only got to pay a quarter of a percent or half a percent a year interest rate. That is pretty easy.

What you will see is that right now, 10 percent of all loans in Japan carry an interest rate of less than a half of a percent. A quarter of loans carry interest rates of less than 1 percent. We are talking about 5 percent that carry an interest rate of less than a quarter of a percent, probably not enough to pay the light bill, and people who actually count the money, you know, make sure it goes to the right computer.

So in other words, the banks are in better shape through various reasons, but a lot of the borrowers are not. And that still remains a drag on the economy, the so-called "zombie borrower problem." It is more stable, yes, but not as conducive to growth as one might think.

So our view is that going forward we still have a weak Japan whose potential growth over, say the next 5 years, is somewhere about 1.5 percent, give or take. In any economy the potential growth you can sustain year after year with full employment, full capacity, is basically the sum of how fast is your workforce growing, and your growth and productivity output per worker. Well, in Japan, the working age population is actually shrinking, and there are more and more retirees per each worker, which raises another question Mr. Len Schoppa referred to.

So that basically any growth that occurs at all is entirely dependent upon productivity growth, and productivity growth for workers trend about 1.5, 1.4 percent a year, for full employment. And while there has been a lot of reform in Japan, it has not yet had enough of a gestation period and has not yet had enough of a critical mass to make any significant difference in that productivity growth.

So if you combine productivity growth of 1.4–1.5 with slight declines of a couple of tenths percent a year in the labor force, we are talking about an economy that at full capacity cannot really grow more than say 1.3 to 1.6. The OECD is 1.3. Japan's own cabinet office talk about 1.6.

So to raise that, Japan will need an awful lot more reform, and I am afraid we are getting a little bit of a reform fatigue in Japan. Sometimes people say we would prefer stability and security. Why go through all this more wrenching pain? Why—you know, our corporations are making money again, at least the big ones are, and they are a much smaller share of the economy than the small and medium enterprises are. Why should we put our division through more wrenching pain if we are already making money, if we are not in danger of financial collapse? Maybe security and stability is more important than growth, and that I think is the attitude.

I think in the long run that is not sustainable. It is not sustainable because you cannot support your growing ranks of aging without an improvement of productivity, without an improvement of returns to assets. Otherwise you have a terrific generational conflict in taxes and things abroad you begin to see. It affects politics. It affects who gets elected.

And so I think in the long run Japan will reform, and I believe a reformed Japan could grow something closer to 3 percent rather than 1.5, but I think we are several years away from that kind of situation.

So in the meantime, if we are talking about what I think is the most likely scenario, it is of a relatively stable Japan, but slow growing, and therefore a Japan which is not really able to play any kind of a locomotive role either globally or in the region.

Now, I think one of the things we learned over the last decade is 10 years ago we used to think Japan was a problem because it was too strong. We have now learned, I think, at least most of us have learned, that Japan is much more of a problem when it is too weak.

I would argue that while Japan did not cause the 1997–1998 Asian financial crisis, that crisis was worse than it would have been had Japan been stronger.

I would also argue, if you look at what is going on in the region, Japan is integrating itself more into Asia, but Asia is not integrating itself more in Japan. It is really China, which is much more—to any extent any country is a dominant economic player in Asia, and increasingly so it is much more China than Japan.

So again if we look at the chart on page 11, what we will see is that in most of the—this is from 2003, I am trying to get updated data. What we will see is that most of the countries in Asia, particularly the new industrializing countries, the more advanced countries, less raw material-oriented, Japan imports far more than does China, and that trend will continue in the future. And there-

fore as countries begin to orient themselves on who is their customer, who are they producing for, what supply chain are they part of, it is much more China than Japan.

If you look at the negotiations around free trade agreements in the region, again Japan is the lead compared to China.

So to the extent that United States policy is oriented around the idea that a revived Japan, a vibrant Japan could be a counterweight to a rising China, not to contain China, but to help integrate China peacefully responsibly, well, I think Japan is not in as good position to play that counterweight role as the Bush Administration had hoped when it came into office.

I think initially, in the initial years, the Bush Administration was very, very focused on helping economic reform in Japan. I think in the post-9/11 world the focus has really been on security affairs. And while I understand that priority, I think we should be able to do two things at the same time, and again for that reason, it is also good that the Committee is holding hearings on this.

Now, in terms of the bilateral relationship, I think there that I do not see any reason for major trade conflicts between the United States and Japan, across-the-board conflicts such as we saw 10 years ago. There will be from time to time individual issues like steel a couple of years ago, beef today. If you want to talk about beef, I will be glad to do so in the question and answer period. But these are particular sectoral issues I do not think have spill-over effects, certainly if managed properly, should not have spill-over effects into the broader relationship.

Ten years ago Japan accounted for 65 percent of the entire American trade deficit. Today, it is down to about 10 percent, and shrinking. There is a chart on that again further down.

Japan has also shrunk in terms of—page 12—Japan has also shrunk in terms of the imports it supplies to the United States. Again, China is rising. Interestingly, for all the criticism of China as the source of the trade deficit, Japan's share of the United States trade deficit is actually no higher today than it was in 1997. In my view, a growing trade deficit of China is a reflection of the growing trade deficit with the whole world, not a China problem in particular.

On the currency side, Japan was the monumental intervention a year or so. It has not been an intervention since April, and nonetheless the yen—rather than rising as many people thought—has actually gone back a bit. So unless Japan resumes its monumental intervention, I do not see the currency issue being a major source of conflict between the two countries.

I would also add that there are some misconceptions, I believe, about the currency issue and the danger that it poses to the U.S. There is a view that the only thing that keeps a dollar from crashing—at least the view in some circles, that the only thing that keeps the dollar from crashing is that China and Japan and other Asian central banks are buying massive amounts of dollar assets to protect their currencies.

In fact, three-quarters of the capital flows going into the U.S. are not from central banks, they are from private investors. One-quarter from central banks all over the world, not just Japan and

China. China's share of the capital flow is on net 6 percent, Japan's is about 23 percent.

We already had a situation—Bank of Japan was buying massive amounts of dollar assets to protect its currency but suddenly stopped last April, has not bought a dime, and yet the currency market has barely shown a hiccup.

So I do not believe that the U.S. is vulnerable, the U.S. financial markets, United States interest rates are vulnerable to either a panic by private investors in Asia, or a central bank action, or some way for governments to hold us hostage on trade issues. I just do not think the U.S. is vulnerable on that issue.

And while there may be other reasons to be concerned about currency issues, the idea that somehow the U.S. is vulnerable to some sort of threat, I think is a misplaced issue.

One final thing—and I see I have run out of time—there has been a lot of progress in Japan of foreign direct investment, as you mentioned, Mr. Chairman. There is some concern now about some possible backtracking because of some recent issues of a hostile takeover attempt in Japan. There has not been one successful hostile takeover in Japan. This is by a domestic company. It got some financing from a foreign—from Lehman Brothers, and therefore the accusation was made this was a Trojan horse for Wall Street trying to take over Japan.

There are some in Japan who are trying to do some backtracking and make takeovers more difficult, delay certain rules like stock-for-stock swaps, to make cross border M&A easier, and so there will be some attempts at backtracking, I think, in Japan. But nonetheless, I think the main trend going forward, despite any sort of—it is two steps forward, one step back—that the openness to foreign direct investment, the positive effects of things like the Nissan case in foreign direct investment are such, and the attitude of the Japanese Government is such that I think despite any partial steps backward, Japan will be more open to foreign direct investments. That will increase, but it is increasing from a very, very small base. The pace of increase is small, and that will not change until foreign takeovers become easier.

And so the movement is in the right direction, but the progress on that is slow.

So let me stop there, and once again, thank you for your attention.

[The prepared statement of Mr. Katz follows:]

PREPARED STATEMENT OF MR. RICHARD B. KATZ, SENIOR EDITOR, *The Oriental Economist Report*, Toyo Keizai America

Overview

A decade ago, many US policymakers felt Japan was an economic threat because it was too strong. Since then, we have learned that Japan is more of a problem when it is too weak. Consider the 1997–98 financial meltdown in Asia. Certainly, Japan's economic weakness was not the primary cause of that crisis. However, its weakness did make the crisis somewhat worse than it otherwise would have been (i.e. it imported less than a strong Japan might have; its banks withdrew more from the region than might have been the case without a banking crisis in Japan.)

With this as a background, the Bush Administration came to power wanting to help Japan make itself economically stronger. Then-NSC head Condoleezza Rice told a staffer that she wanted him to focus on Japan's banking crisis because, without solving the banking crisis, Japan could not become healthy. And, in her view, an

economically vibrant Japan was needed as a counterweight to a rising China in order to help China peacefully integrate into the community of nations.

In the post-9/11 world, America's economic concerns with Japan have been put on the backburner, as security issues come to the fore. Partly this is because Japan no longer seems as fragile; partly this is because of current primacy of security concerns in Asia.

In this atmosphere, we should not lose sight of several economic developments in Japan that, while not making page one headlines, will play an important role in the geo-economics and geopolitics of Asia in the coming years. In our view, the following developments are the ones for US policymakers to monitor in the coming years:

- 1) Japan has regained a great deal of financial stability. To the extent that there was ever a risk of financial meltdown in Japan—either through a banking crisis or a government bond crisis—that risk is significantly reduced.
- 2) Nonetheless, Japan remains economically weak. While it has probably escaped the zero growth syndrome that afflicted it in 1997—early 2002, its growth going forward will probably be no more than 1.3%–1.6% over the next five years. It will not be able to play much of a locomotive role either globally or in Asia.
- 3) Japan lags behind other countries, notably China, in the webs of trade and direct investment and formal trade agreements that are creating an increasingly integrated Asian economy. Japan is not in position to play the role of economic counterweight to a rising China.
- 4) US-Japan trade frictions will not be a big issue in the coming years. To be sure, from time to time, there will be important sectoral disputes, e.g. steel or beef, that draw a lot of attention. But the kind of across-the-board tension seen up through the mid-1990s will not likely return. Unless Japan returns to the massive currency intervention seen in 2003 and early 2004, currency disputes will not loom large either.
- 5) There has been a tremendous improvement in the ability of foreign firms, including US firms, to operate in Japan. Foreign Direct Investment (FDI) has increased sharply, but that is still from a very low level.

Financial Stability

The most immediate threat to Japan was its long-lasting banking crisis. In the last few years, that threat has been greatly reduced. Banks have reduced their official level of nonperforming loans to 5.2% of all loans. The major banks are well on their way to meeting the government's goal of reducing the NPL ratio to around 4% by March 2005 (see charts on pg. 8)

Unquestionably, an NPL ratio of 4% is a lot safer than the 10% ratio seen back in 2002. In another good sign, there is finally less new bad debt being generated than the amount of old bad debt being written off.

We would add some caveats, however. There are still some questions about the reliability of the Japanese government's data. Nonetheless, even skeptics agree that the trend has moved significantly in the right direction.

Japan still lags behind standards elsewhere, such as the US. Among US banks, NPLs are only 1.4% of all loans. Moreover, the US Federal Reserve slaps the "delinquent" label on a loan delinquent if interest payments are merely 30 days overdue. The FSA does not call a loan nonperforming until it is three months overdue.

Also, keep in mind that, in Japan, bank loans are still 80% of GDP, compared to about 40% in the US. Consequently, Japan's NPLs today still amount to 4.6% of Japan's GDP—eight times the 0.6% NPL/GDP ratio in the US.

Moreover, a significant part of the debt write-off occurred due to debt forgiveness and debt-for-equity swaps. Not all of the borrowers given such relief are in any better position to avoid new bad debts in the future.

There are a couple indications of this. Despite the improvement in corporate profits and the economy in general, too many firms are being kept alive by incredible low interest rates. As of November 2004, 5.7% of all bank loans charged less than 0.25%—barely enough to pay the light bill or the clerks who count the money. 10.5% of all bank loans charged less than 0.5%, up from 9.7% a year earlier. 23.5% charged less than 1%, up from 22% a year earlier. 37.6% charged an interest rate below 1.5%, up from 35% a year earlier. 59% of all loans charged interest of less than 2%, up from 56% a year earlier (see figure on pg. 9).

According to calculations we made based on data from Ned Akov of Macquarie Securities, marginal firms—those unable to afford a 2% hike in interest rates—still hold a huge 18% of total company debt. While that's a lot better than the 43% figure in March 2002, 18% is still a very high figure (see figure on pg. 9).

Naturally, the picture is markedly better at the listed corporations, where profits have increased more and where some firms have enjoyed debt forgiveness.

So, the financial picture is more stable, i.e. less susceptible to crisis. The banks are in better shape; many of the borrowers are not.

Recent Developments

Japan just went through what some observers call a “technical recession” and others call “an extended pause.” Whatever you choose to call it, the fact remains that, in 2004 Japan’s GDP declined mildly for two quarters in a row (April–June and July–September), and barely grew in October–December.

The big question is what comes next—both in the short-term and the long-term. On this issue, the level of uncertainty is quite large. Many analysts believe the economy will resume its expansion in the first or second quarter of 2005; others believe it will take longer.

Consequently, the range of growth forecasts for fiscal 2005 (from April 2005 through March 2006) is unusually large. The NLI Research Institute predicts only 0.3% growth, whereas the Norinchukin Research Institute and BNP Paribas believe growth will hit 2%. In the middle are the Daiwa Institute of Research (0.6%), the Mitsubishi Research Institute and Nomura Securities Financial & Economic Research Center (1.1%), and Credit Suisse First Boston and Mizuho Securities (1.5%).

Beyond that, the pause has more or less ended the ebullience that led some forecasters to see 3–4% annual growth for several years to come. Now medium-term forecasts are in the range of 1–2% or, in some cases, 2%+.

Mid-Term Prognosis: 1.3% to 1.6% Growth

Because of the reduced financial instability, Japan is unlikely to have a repeat of the financial turbulence that created five years of slightly negative growth from January–March 1997 through January–March 2002. The bad news is that, for the next several years, Japan is probably going back to nothing more than the mediocre growth seen in 1991–1996.

We believe that Japan’s “potential GDP growth,” i.e. the rate of growth it could sustain over the medium to long-term if it operated at full-employment/full-capacity, is still around 1.5%. The reason is this: GDP growth is sum of growth in the labor force plus growth in GDP per worker (i.e. productivity growth). Trend labor productivity growth is still around 1.5% a year or so, and the working age population is starting to decline.

This is a fairly conventional estimate. The OECD puts the figure at 1.3%. Japan’s Cabinet Office predicts that Japan’s growth through 2012 will be around 1.6%.

We believe that, with enough reform, Japan could do much better. For example one economist has calculated that, if Japan took 20 years to get up to US standards of productivity, that alone would add an additional 1.5% a year to existing levels of growth. Hence, in a reformed Japan, growth should be closer to 3% than 1.5%.

There has been a lot of reform already. And more is coming down the pike. Nonetheless, reform still lacks both the critical mass and the gestation time necessary to create a significant upward shift in potential growth. Firms, for example, are financially stable, but are still plagued by widespread inefficiency. Particularly at the small and medium sized firms that produce the lion’s share of Japanese GDP, much of the recent increase in profits has come, not from genuine increases in efficiency, but from cuts in wages. For example, full-time workers who get health and pension benefits are being replaced with part-timers who don’t get these benefits.

There is the danger that policymakers in government and business will regard 1.5% or so as “enough.” They may prefer mediocre growth as preferable to the political and economic shakeups engendered by serious reform.

In the long run, we don’t believe low growth is politically stable. The aging problem alone requires better growth and better productivity. With the ratio of workers to retirees falling from 5 workers per retiree to only 2, unless each worker can start producing a lot more GDP, and unless returns on assets start improving, it will be very hard to support the growing ranks of the elderly. A generational crisis is incompatible with political stability. Nonetheless, in the short to medium run, “reform fatigue” is a genuine danger at the government level and at the firm level.

Recent growth trends

Let us consider recent growth trends in this context. Prior to 2004, the year 2000 was the only year since 1997 in which growth was higher than 1.5%. As a result, Japan entered the current recovery with actual GDP far below its full potential. To get back to full capacity, Japan needs to have several years of growth above 1.5%. Yet, it is so far finding sustained growth above 1.5% hard to come by (see chart on pg. 10).

One reason is that the recovery of the past couple years has been inordinately dependent on two sources: exports and business investment. During the period of fastest growth—the four quarters ending in January–March 2004—exports provided almost half (43%) of all GDP *growth* even though they amount to only 13% of GDP. Net exports (i.e. exports minus imports) provided almost a third (28%) of all *growth* even though they amount to only 3% of GDP. Much of that was due to exports to China, as Japan supplied parts and machinery that helped feed China's own export boom. In the four quarters ending in January–March 2004, capital investment provided almost a third (30%) of GDP growth. This, too, is a disproportionate contribution, considering that investment is only 16% of total GDP.

Due to pressure on wage income, personal consumption has been a laggard throughout this recovery. Even though consumption equals about 55% of GDP, it provided only 25% of growth during the four quarters ending in January–March 2004. And in parts of 2004, year-on-year growth in consumption turned negative.

With the economy so precariously dependent on exports and business investment, any faltering of those two sources of demand brings growth to a halt. That is what happened in 2004.

Japan Falling Behind China in Asian Trade

A few years back, some people in Tokyo spoke of Japan becoming the hub of Asian economic integration. Nothing could be further from the truth. Japan is falling far behind China in many of the key trends: trade, trade agreements, and foreign direct investment (FDI).

In many countries, China is already a bigger customer than is Japan. This is particularly true for imports from the Newly Industrializing Economies (see chart on pg. 11). Partly this is due to Japan's slow growth compared to China. Partly this is because Japan still imports comparatively little (relative to GDP), whereas China is a big importer. Beyond that, while Japan's imports have increased substantially in recent years, the lion's share of the increase is from Japanese companies' own overseas affiliates (e.g. importing back to Japan Matsushita TVs made in Malaysia), rather than from indigenous Asian firms.

Japan is also falling behind when it comes to the FDI surge in Asia. In early 2004, Korea overtook Japan passed Japan to become the second biggest investor in China after Hong Kong. According to a report by Credit Lyonnais Securities Asia (CLSA), Korea accounted for 16% of all Foreign Direct Investment (FDI) into China. That puts it ahead of Japan (13%), the US (11%) and Taiwan (9%). If current trends continue, the gap between Korean and Japanese FDI into China will grow further.

While Japan remains Korea's biggest supplier, China is rapidly catching up and may soon overtake Japan.

To the extent that political trends follow economic interdependence, these economic patterns are important to monitor.

US-Japan bilateral trade issues

Except for occasional sectoral disputes, e.g. steel and beef, a blow-up in bilateral US-Japan trade tensions is unlikely in the next few years. The primary reasons are that 1) Japan is no longer seen as a "threat" to major US industries as it was a decade ago; 2) Japan's share of the US trade deficit and of US imports are both rapidly shrinking.

While the trade deficit with Japan has been increasing, this is primarily a *reflection* of the growing global US deficit rather than a *driver* of it. The same, by the way, is also true of China to a large degree.

Japan's share of the US merchandise trade deficit has fallen from a peak of 65% back in 1991 to only 10% as of early 2005. Japan's share of US goods imports has fallen from a peak of 22% back in 1986 to 8% as of early 2005. Meanwhile, China has surpassed Japan both in terms of the bilateral trade deficit and in imports (see charts on pg. 12). Interestingly, while the deficit with China has been growing, the overall US deficit has been growing so fast that China's share of the total US trade deficit is no higher today than it was back in 1997.

US exports to Japan are also sinking, but that is not currently a trade issue because most US firms apparently believe that, even with greater propensity to import by Japan, the anemic economy makes sales an uphill climb. Meanwhile, US exports to China are growing and, if present trends continue, US exports to China will exceed exports to Japan in the not-too-distant future (see chart on pg. 13).

Currency issues

There are many prevalent myths about the dollar's foreign exchange value and the role of Asian central banks. One of these myths is that massive intervention by Asian central banks—particularly those of Japan and China—is the prime reason

for the dollar's "high" value. Were these central banks to stop buying, it is said, the dollar might crash.

First of all, the vast majority—about 75%—of purchases of securities are done by private foreign investors, not central banks. All of the central banks in the world—not just those of Asia—account for only a quarter of net purchases of US securities (see chart on pg. 14).

Secondly, Japan and China account for a minority of foreign purchases of US assets. In the second half of 2004, China (public and private sources combined) has accounted for only 7% of net capital inflow to the US, while Japan has accounted for 23%. On a gross basis (i.e. counting only foreign flows to the US and not vice versa), Japan provides only 6% of the capital (see chart on pg. 15).

As to what would happen if Asian central banks stopped buying, we have already run this experiment. Japan's central bank did intervene on an absolutely monumental basis during much of 2003 and early 2004. But it has not intervened at all since last April and yet the currency markets have barely hiccupped.

There are those who worry that Japan and China own so much of US Treasury debt that they could hold the US hostage. In other words, they could threaten to sell these assets, thereby supposedly creating turmoil in US financial markets, including US interest rates. This is an exaggerated fear. First of all, when the Bank of China and Bank of Japan buy dollar assets, they do so, not as a favor to the US, but to protect their own exports. Selling the dollar would be shooting themselves in the foot.

Secondly, the Japanese/Chinese share of US market debt is too small to create that sort of turmoil. Japan and China together hold about half of the *foreign-owned* portion of Treasury bonds. But altogether, foreigners own only 20% of Treasury debt, so the Japanese-Chinese share is only 10%. More importantly, US interest rates are determined, not simply by Treasury debt, but by demand and supply for all marketable debt. Almost all foreign purchases of US debt involve Treasury debt. But the latter is only about 30% of all marketable debt in the US. That means that the foreign ownership of all US government and private debt is only about 5–6% of the total (see bottom figure). Consequently, even if Japan and China substantially reduced their purchases of US Treasury debt, the effect on US interest rates would be well within the powers of the US Federal Reserve to manage (see chart on pg. 15).

Foreign Direct Investment

After years of resistance to foreign direct investment (FDI), Japan finally began to reverse itself in the last few years. Previously, FDI was seen as a threat to the autonomy of Japanese firms and to the emphasis on "stakeholders" rather than shareholders. But, due to the economic crisis, FDI began to be seen as a source of jobs, as a way to rescue troubled firms (like Nissan), and as a way to pressure Japanese firms to make necessary reforms.

Officials at METI began to work with US officials, particularly the State Department, to find ways to encourage more FDI into Japan. In 2003, Prime Minister Junichiro Koizumi declared a goal of doubling FDI into Japan by 2008. Any doubling would be welcome, but it comes from a very small base.

Finance Ministry data shows a hefty increase in both the annual flow and the cumulative stock of FDI (see chart on pg. 16), but OECD data shows a somewhat different picture. A few spectacular takeovers, e.g. Renault's takeover of Nissan and Ripplewood's takeover of Long-Term Credit Bank (now Shinsei), have created headlines and raised the aggregate numbers. We believe the trend is positive and will accelerate.

Nonetheless, Japan has a long way to go to meet international norms. In 2003, Japan's 0.15% of GDP figure for inward FDI put it dead last among 30 OECD countries. Japan's highest year so far in inward FDI was 1999, when it was about twice the 2003 figure. Over the 1999–2003 period, Japan's inward FDI was 0.2% of GDP, about 1/8th the US level. 2004 should be much higher according to initial MOF data.

Going forward, what will be critical is the ability to buy Japanese firms. Globally, as much as 80% of the FDI takes place via purchase of existing firms rather than setting up entirely new "greenfield" facilities. Buying an incumbent firm gives the acquiring firm a workforce, management, suppliers, a customer base, distribution, good will, etc. So far, it has been very hard to buy Japanese firms except for those in such trouble that they need a rescuer. Healthier firms do not sell themselves—to either foreigners or other Japanese. So far, there has not yet been one successful hostile takeover in Japan. We believe that will eventually occur, but we cannot say when.

One obstacle has been the “cross-shareholding” system in which corporate allies own each other’s shares and protect each other from takeovers. Firms attempting hostile takeovers have seen the corporate allies circle the wagons.

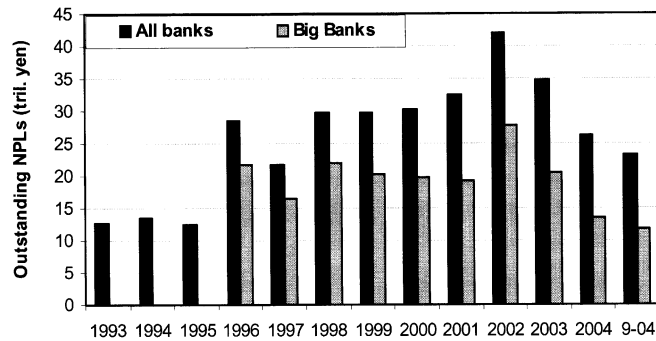
Another obstacle has been the inability to use stock-for-stock swaps in cross-border transactions. The Diet is about to pass a bill lifting this restriction, but implementation is being put off for a year to give Japanese firms time to erect takeover defenses.

The Diet is currently in a rush to pass a number of legal changes that will give firms more legal defenses against hostile takeover, such as poison pills. Up to now, Japanese firms have had few of the legal defenses available to US firms, because the cross-shareholding system made them superfluous. With cross-shareholding being eroded, firms are asking for these legal defenses. They are being sold as a way for firms to protect themselves against foreign takeovers, but they will hinder hostile takeovers by domestic firms as well.

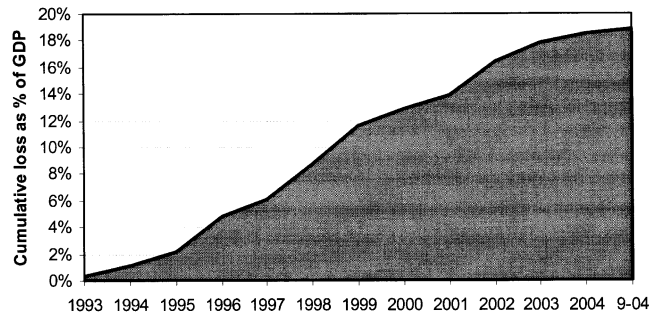
Conclusion

Most of the big economic issues concerning Japan in the next few years will not be focused on bilateral economic ties, but rather Japan’s role in the economics and political economy of the Asia-Pacific region. Japan remains America’s key ally in Asia, but it lacks the economic wherewithal to play the role that many in the US would like to see it play.

NPLs dropped to lowest level in years. . .



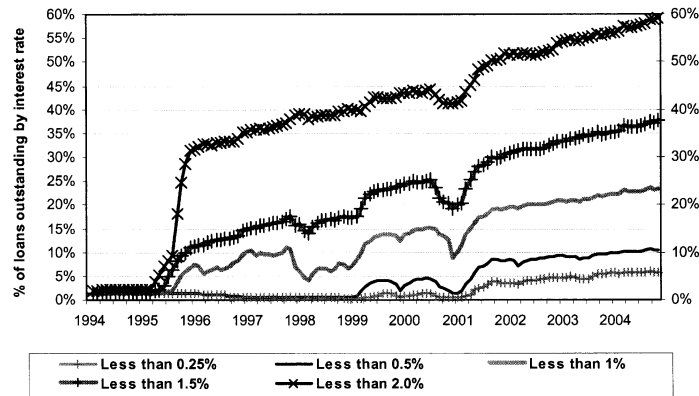
. . . But cumulative cost is nearly 20% of GDP—so far



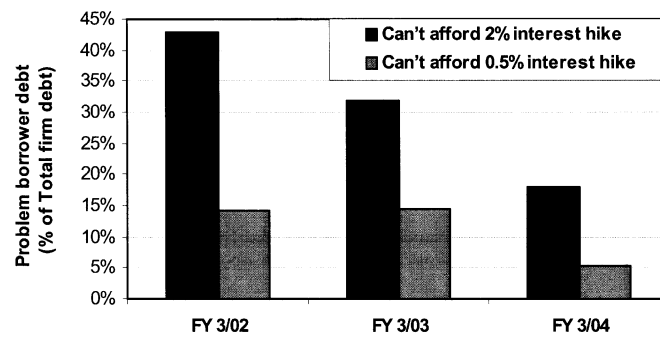
Source: FSA at www.fsa.go.jp/news/news.html

Note: Figures are as of March of the year indicated, except for last column which is Sept. 2004. Cumulative bad debt equals current NPLs plus NPLs written down or written off since fiscal 1992.

Ultra-Low Interest Rates Still Growing As Share of Total

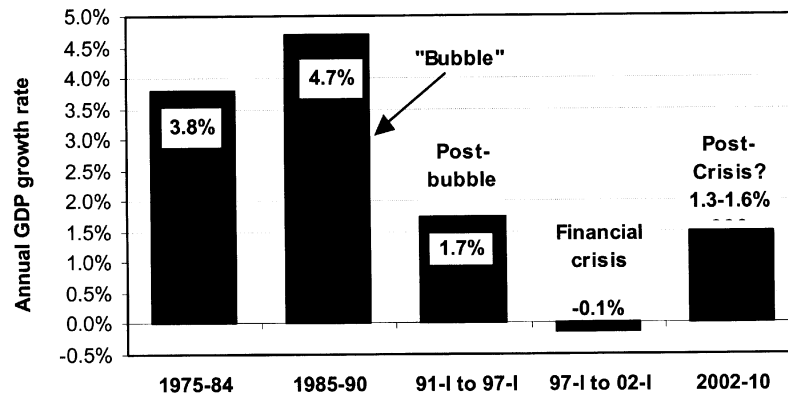


Fewer distressed firms, but still quite a lot

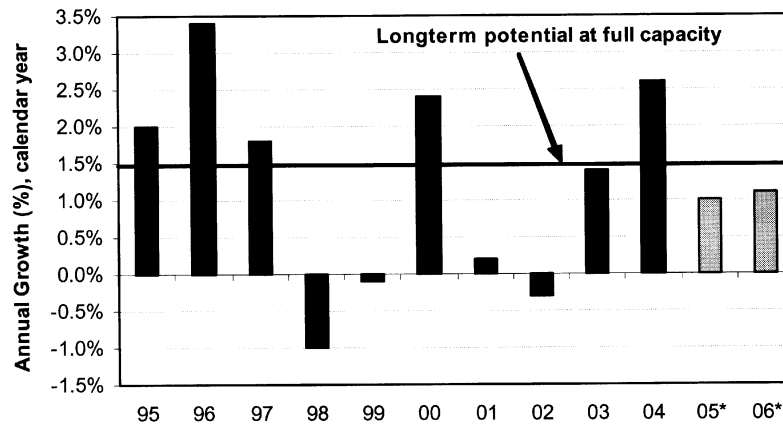


Source: Author calculation based on data from Ned Akov of Macquarie Securities Research (Tokyo) and Bank of Japan. Akov calculated the ratio to total bank lending; we adjusted this to count lending only to companies.

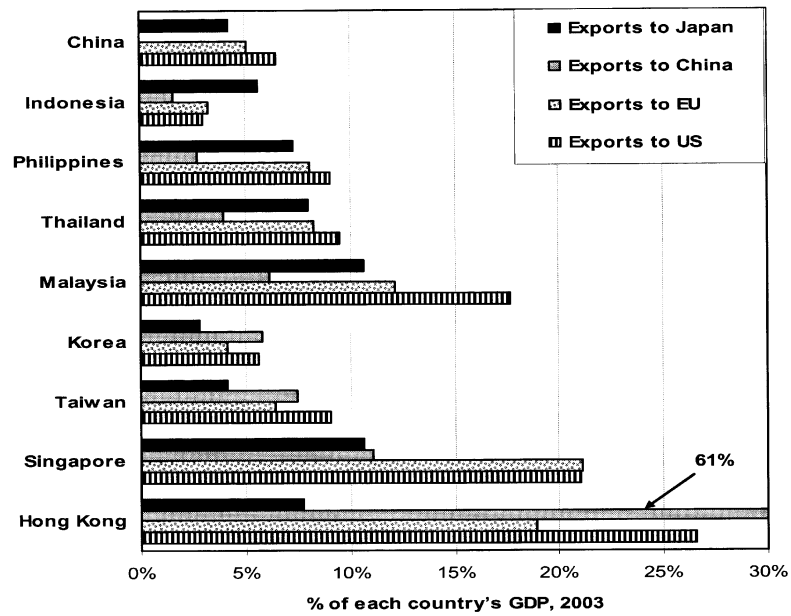
Recovery to what?



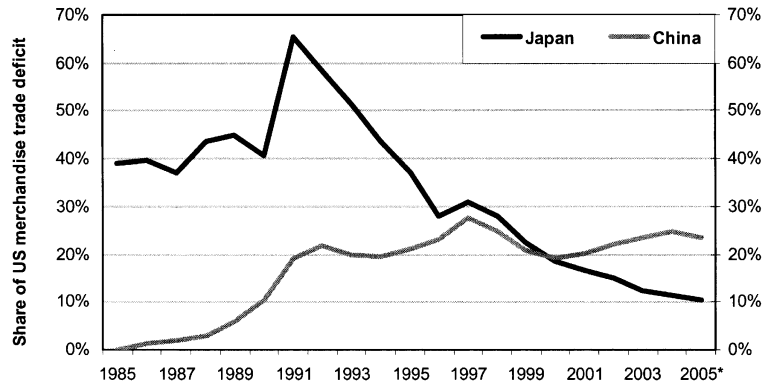
One good year?



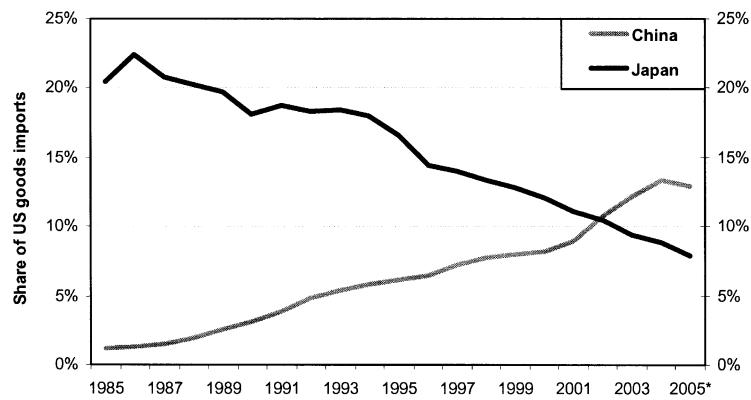
Note: 2005-06 based on a forecast by Peter Morgan of HSBC (Tokyo)

China beats Japan as Asia's customer

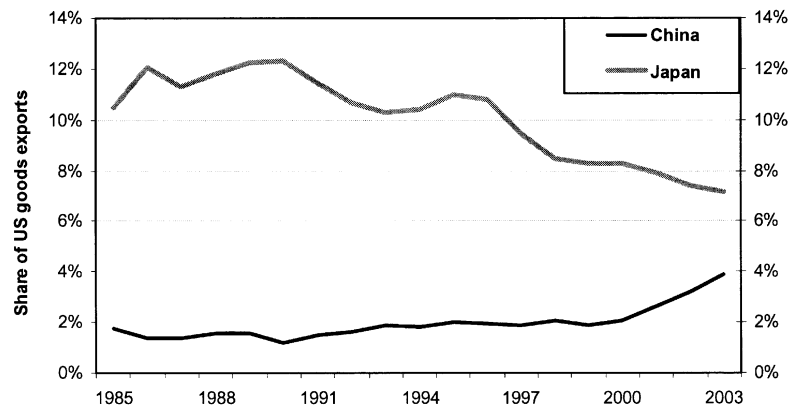
Japan's share of US trade deficit falls; China's no higher in 2004 than in 1997

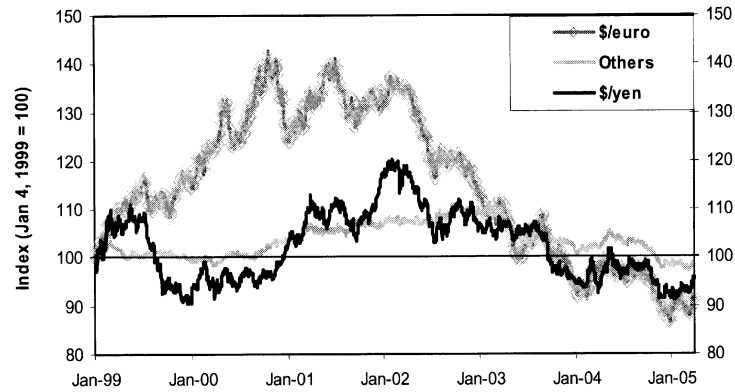
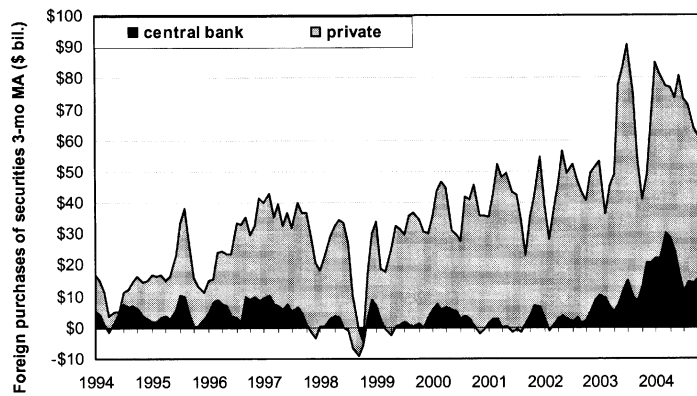


Japan's share of US imports falls; China's share surpasses Japan's

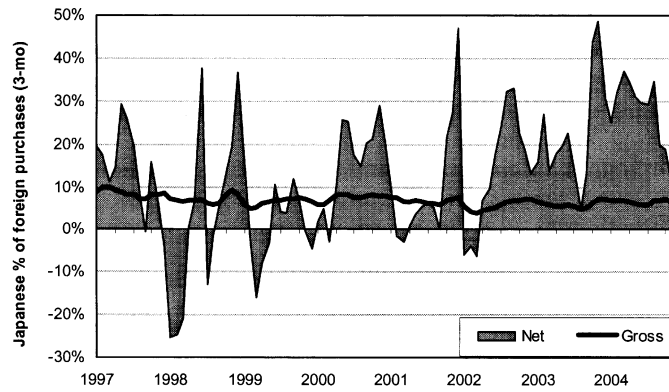


Source: Commerce Dept at <http://www.census.gov/foreign-trade/www/index.html>

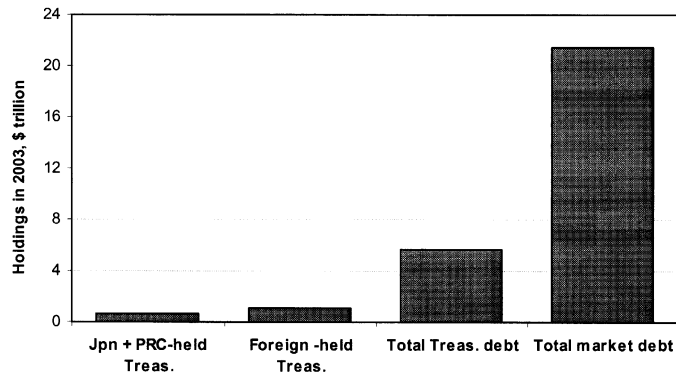
US exports to Japan sink, but China buying more

Dollar falls more against Yen and Euro than others**Private investors, not central banks, send most of foreign capital to US**

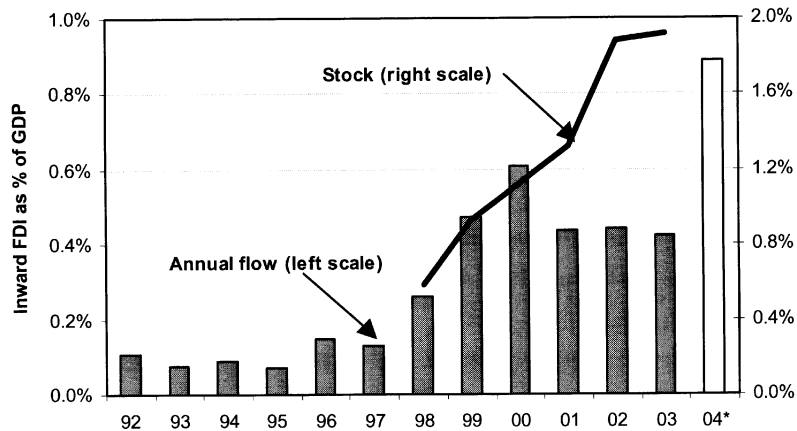
With end of official intervention, Japan accounts for just 10% of net capital inflows to US



China and Japan account for small share of total marketable debt

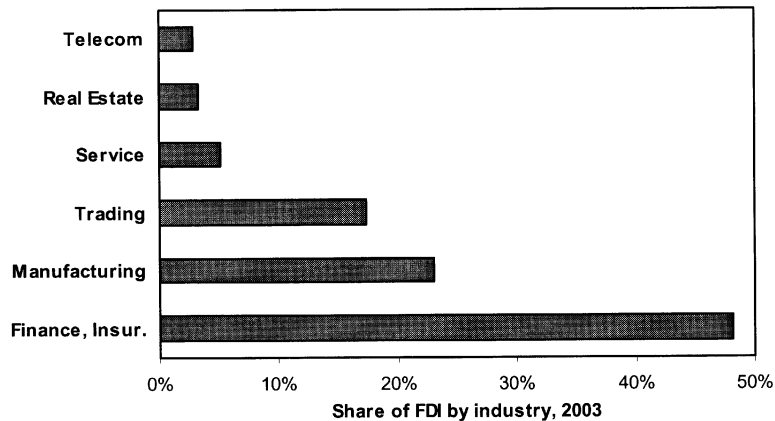


FDI Rising, But From A Small Base



Source: Ministry of Finance

Finance is the most popular target



Mr. LEACH. Thank you very much, Mr. Katz.

Let me begin with a micro question, then move to a larger one. You indicated you might entertain a question on beef. As a representative of the State of Iowa, I want to first challenge your one comment that it is not of great significance. It is to the Midwest, and probably Japan's greatest potential American supporters are the American farmer, and this ban on the importation of American beef is deeply irrational, and thoroughly protectionist.

And based on one incident of mad-cow disease in the United States, to establish a ban and prolong a ban is indefensible.

Now, would you care to comment on that perspective?

Mr. KATZ. Sure. I believe that—well, first of all, I eat American beef, so I do not have a problem with the safety of it. I believe the source of the problem in Japan is not a classic case of trade protectionism as we have seen in other issues of platt-glass or a whole host of issues where a safety issue is merely being used as a pretext.

I believe that what has happened in Japan is there have been a number of cases involving the health and safety of the Japanese people where the Government has really mismanaged things very badly, including the mad-cow issue, and HIV, tainted blood in milk, et cetera.

The consumption of Japanese beef dropped by half in Japan, and there is such a huge amount of mistrust. There have been 17 cases now in Japan of mad-cow. The mistrust of Japanese Government by its own people became so severe that the Government turned it over not to the normal ministry—which are protectionists in many cases, the Ag. Ministry—but to a food safety commission filled with scientists and academics, which has been taking much longer than the Government expected it would take to resolve the issue. I think the Government genuinely believed that by now it would have been resolved and imports would have been resumed.

The problem they get is that the Japanese people are very concerned about their health. Their concerns may be misplaced, but nonetheless it does have that perception, and it does have political sway.

I believe the Japanese Administration is in a bit of a pickle here. They would like to get the beef imports resumed, but if it looks as if they are interfering with the food safety commission, they have to pay a political price. And it may be that if the Japanese people believe that beef which is not totally safe is being shipped there, they may choose not to buy it.

My expectation is that the beef imports will resume. The commission has already made a decision on domestic beef that allows cows under 20 months of age basically be allowed without individual inspections. That will then, through a certain process, be applied to imports, but I do not think it is going to happen tomorrow. I think the earliest that could happen would probably be by summer, just because of the nature of the process. It could take a bit longer.

And I am not saying it is a happy situation or a justified situation, but if you are asking me what I think is going to occur, that is my best guess of the situation.

Mr. LEACH. Well, let me just be very precise from an American perspective. Whatever the process, it is irrational. To be concerned for safety is profound. To not recognize that we have no safety problem in the United States at this moment is not a very sophisticated way of looking at the world.

The United States has taking enormous steps in recent years and has been very careful on the safety issue. And if we were not, we would not even have announced that we had one incident many, many months ago. And around the world, people are using incidents to advance the larger issue.

Now, you are certainly correct in saying this is a matter of Japanese public concern. It is a matter of safety. Likewise, in Europe there are huge safety issues that have arisen around American ap-

proaches to agriculture, most of which have not been proven to be a problem.

But to defend the circumstance based upon a Japanese safety concern is not to defend the rationality of the situation, and it really invites American counter-reaction, and you know, this week we see an announcement that a major American company lost a billion dollars in the first quarter. That becomes a national security concern in the eyes of some. And if people cannot deal with issues in a credible timeframe in a professional way, it is inevitable that reactions develop. So I really would urge the Japanese Government to think this through.

Let me turn to one issue and to the other two witnesses who particularly addressed this to some degree. We are seeing the power of nationalism rise in recent months, particularly as it relates to historical factors. This is very awkward for Japan. It is also potentially awkward for the United States, and there are also, to me, lots of symbolism. I mean, if you have kind of nationalistic responses to Japan, you could have them against the United States as well, as well as the United States' interests, whether it be in resolving certain issues, particularly North Korea, but also the stability in general.

How significant do you view the rise in nationalism in Asia, and its implications for Japan and the United States?

Mr. BERGER. I view it very seriously. Nationalism is not entirely new to the Asian region. I think it is worth observing in particular with respect to both South Korean and Chinese nationalism, that anti-Japanese sentiments have a long and distinguished pedigree in those countries. Modern Korean and modern Chinese nationalism have their origins in protest movements—the May 4 movement and the March 1 movements in China and in South Korea, respectively.

These issues have always been there, but for a variety of circumstances having both to do with international situations and domestic situations in those countries, they are coming to the fore with increased vigor today. Now, again, that is something we have seen at different points in time in the past.

With respect to Japan, I think we have to understand that there is a segment of Japanese public opinion which has strong views on history. That segment of public opinion is demographically—those people who were told what are sometimes called generally revisionists or hard nationalist views are relatively—represent a relatively small percentage of the population. You can calculate it in different ways. Some place around 10 percent would be the usual figure people use. That, by the way, is pretty comparable to what you see in other advanced industrial democracies around the world, including in Western Europe. And there has been a tendency historically—this group is also very well connected politically in Japan, perhaps more so than it would be true, let us say, of Germany or France or Britain.

Now, what we have seen historically is that whenever we have debates in Japan on defense national security, whenever the Japanese try to get serious about this, these issues always come up again. There is a very strong sentiment, both within the right but also within broader circles within the center and center-right in

Japanese politics, that Japan has an incomplete sense of self; that Japanese nationalism has suffered historically a severe blow relating to its defeat in World War II, which was not only a military defeat, but—as many Japanese interlocutors have pointed out to me—it was also in some ways a moral defeat, and relating also to the occupation.

As a result of this lack of sense of pride, patriotism, one person's nationalism is another person's patriotism, has different nuances, Japan has had difficulty rallying public support.

So for Japanese conservatives and also for a broader spectrum of opinion beyond public conservative or traditional conservatives or right-wing views in Japan, if you want to get serious about defense, you need to encourage patriotism. You need to encourage a sense of willingness to sacrifice on the part of the population to support these things.

So this happens whenever we have this kind of situation. We had it in the sixties, we had it in the seventies, eighties, and again today.

Now, unfortunately, this trend focuses again on things like textbooks. It is upon sites of commemoration, public commemoration like the Yakukuni Shrine. These are the sort of symbolic issues which naturally come to the fore.

Now, unfortunately, this is coming together at the same time as other trends are taking place, especially in South Korea, and the People's Republic of China. In South Korea, we have had a long drawn-out democratization process dating—you can take it back to the Seoul Olympics in 1986, and the slow steady march toward a more pluralized, more democratic legal system. The current Government, the Roh Moo Hyun Government in South Korea comes out of a democracy, human rights, democratic activist background, the Uri Party. Most of them, by the way, are new. I mean, very few of them have much experience in this area.

And certain sentiments which were for a long time suppressed in Japan—in South Korea, certain aspects of South Korea is a very difficult past. You can see this in South Korean politics as well.

The Hyun Government set up a committee a few months ago to investigate the past, not in Japan, but with respect to collaboration on the part of Korean or descendants of Korean lawmakers and people in high public places inside of Korea. This they see as part of the democratization process, looking at this history of the current Korean leadership, an issue which is extremely sensitive, and for a long was suppressed in Korea and is being now addressed. This has implications for relations in Japan.

In the People's Republic of China, China is not a democratic system but it has, we should recognize, become much more pluralized for a long time. During the Mao Zedong period, and in the Deng Jau Ping period, much of China's history was suppressed. One of my friends who comes from Manjing was an historian in oral history in the 1970s, the University of Nang Jing, talking to people who, you know, wanted to talk to older people; what are your memories of this city, and they came across all of these stories about the Nang Jing massacre and what happened in 1937.

And when they wanted to publish those results, the message came from Beijing, you cannot publish this. This will be damaging

to our relations with Japan and the outside world. It was not until 1982 that we had the first public monument to the Mang Jing massacre set up.

So for a long time that history has been suppressed, and as China becomes more open, those sentiments which have been suppressed come to the fore. And this is the other important aspect in China, which we have also seen in Chinese protests against Japan since the 1980s, I have been told by Chinese students who have protested that it is difficult to protest openly against the Chinese Communist Party. Tried it in 1989, did not work too well on June 4 of that year.

It is possible, however, to protest against Japan. That is patriotic. That is legitimate. That is problematic for the CCP, for the Chinese Communist Party to crack down on because it looks anti-patriotic.

So this nationalism and this anti-Japanese sentiment, which is tied to that nationalist in these two countries, come together, and we are getting together with Japan's new defense activism, in some ways conditions for a perfect storm, if you will, for these kinds of passions. I think they can be managed, but it will be difficult.

I think the Chinese Government, judging by what I read in the newspaper this morning, Minister Lee apparently has put out the signal that for the sake of social stability, these kinds of protests should be restrained. I think the Chinese Government is moving in this direction, but it will be difficult.

I think it is important to recognize that this is not something that can be turned on and off like a tap, and it is also difficult in Tokyo. So I think we have got—this problem is going to be here for awhile and can damage relations in a number of different levels.

Mr. LEACH. Yes?

Mr. SCHOPPA. If I may add just briefly, Tom spoke about the hard-core nationalists within Japan. I do not think there has been a particular increase in the size of this population. That is not the danger to the stability of the region. It is that the mass public is becoming increasingly concerned about China, especially when they see the kinds of protests that have occurred recently, and it has created an environment where it is very difficult for politicians to apologize.

The worst kind of situation to put Prime Minister Koizumi in is for the Chinese to say you have got to apologize first. No, you apologize first. It could just go on escalating from that point. As long as the mass public is so attentive, as they are now, they are not going to let the Japanese leaders make the kinds of apologies or take the kinds of steps that might actually reassure China.

On the other hand, the mass public in Japan, maybe in most places, can be quite fickle, and these feelings are not that deep. So we can see the example of how Prime Minister Koizumi's breakthrough visit to North Korea, for example, was welcomed by the vast majority of Japanese. Even though they are very concerned about North Korea, when he took steps to visit and he seemed to have a breakthrough, this was greeted with enthusiasm.

So we can hope, maybe the American Government can encourage this kind of strategy, that after things settle down a little bit some Japanese leader, maybe Mr. Koizumi, might have the courage to

take these kinds of steps and be welcomed for his ability to simmer things down.

Mr. LEACH. Thank you. Ms. Watson.

Ms. WATSON. Mr. Chairman, I want to thank you for holding this hearing on the changing Japan.

I agree that it seems to be more of a nationalistic approach that Japan is taking, and I am just wondering since we maintain 53,000 troops in Japan, and about half of them are stationed on the island of Okinawa where I worked for 2 years way back when, and as the United States realigns its global forces, we would hope that Japan will work with us to achieve an overall strategic cohesion that was hoped for when the revised guidelines for the United States-Japan defense cooperation was announced in 1997.

My interests at this time is: Is Japan moving in any direction to join in some kind of cohesive moment in that area given China and its seemingly outrage toward Japan? And we have been dealing with China on the Korean-North Korean question, and either one of the three of you, maybe Dr. Schoppa: Do you sense that Japan is willing to join with us, and might Japan acquire nuclear weapons and a doctrine of preemption?

I am just wondering where they are moving in that direction. Can you respond?

Mr. SCHOPPA. Sure. The Japanese Government has been steadily expanding the role of Japanese defense forces, and certainly their decision to deploy troops to Iraq was an unprecedented kind of breakthrough step for the country.

I would not encourage or hope that the Japanese respond to the recent events in China by deciding now is the time we need to expand even more rapidly. That is the worst kind of environment in which Japan might expand its defense role, and certainly moving toward nuclear weapons or anything of that sort in the current environment would be incendiary. For the foreseeable future, any move toward a nuclear option would be incendiary.

I do think that once things settle down the Japanese foreign ministry and the strategists of the Japanese Government are going to be considering ways to continue to expand their defense role and work closely with the United States, but I think we can see in the recent events how sensitive the feelings are among Japanese neighbors, and I would hope that the United States as it engages Japan in discussions about what exactly its role should be, would always be very conscious of those sensitivities.

Ms. WATSON. Since its takeover of Okinawa as part of Japan there has been from time to time calls for "Yankees Go Home" for our military to move out. What do you see in terms of that since we have so many troops?

In fact, when my colleague, Representative Lynch, and I and a group of others went to the tsunami area we were very pleased to see the response from our military that came up from Okinawa, and they were supplying the most emergent and most immediate needs of the people in Sri Lanka and around in the tsunami area. And I am just wondering what the tone might be in Okinawa in terms of that reoccurring theme of remove your forces out of this area.

Mr. SCHOPPA. Sure. I suspect that Dr. Berger will want to comment to some degree on your question.

Ms. WATSON. Please do.

Mr. SCHOPPA. Go ahead.

Mr. BERGER. Well, both your earlier question and your later question—four—nuclear issue, preemption, China, and the tsunami relief.

Nuclear issue, the Japanese Government has a very nuanced proposition on nuclear weapons. It is clearly not in Japan's interest. Japan has a policy of being a non-nuclear State. Its anti-nuclear sentiments are very strong in Japan, having been the only country which suffered not one, but two atomic attacks, and in addition to that, the Japanese do not want it.

Certainly they are capable. I mean, they are sitting not on pounds but tons of plutonium, which are produced by their breeder reactor program, and they are capable of going nuclear. They are not interested. They do not—it is illegal and it is not something they want to do.

Now, on the other hand, everyone in the region knows that if the Japanese want to go nuclear they can. Some people would say that Japan has a recessed nuclear capacity, and that, I think, weighs upon decisionmakers in Beijing and elsewhere.

Now, with regard to the preemption issue, which is a little bit different because preemption has come up recently, the former Director of the Defense Agency, Ishiba, talked about preemption against—as an issue that or a possibility that Japan might consider using conventional weapons if they see a possible missile attack coming from North Korea.

The Japanese Government first made those comments. Mr. Koizumi quickly denied that this is going to become Japanese policy. It is, however, one of the things which the Japanese are looking at and seriously thinking about. And as we move forward with a ballistic missile defense system for the region, something which the Japanese have now signed on not only to develop but also to deploy, these kinds of questions are going to come up more, because as the Japanese become integrated with our commands and control system, they have destroyers, they have much of the hardware to conduct and support those kinds of operations while—let me put it this way—there may not necessarily be a Japanese independent preemptive strike capability, but there may be a Japanese finger on the trigger of a preemptive strike capability, or at least a hand guiding, you know, which way the barrel points. So this is something that the Japanese are going to have to work through on how they are going to structure that.

China—obviously Japan has strong interests, economic interests in China. I think Japan shares with the United States a belief that it has to integrate, to try to engage China economically, politically, and integrated into the international system. I think we see it in much the same way, and I should say the Japanese probably feel that even strongly.

I mean, many in the United States view China as a potential challenger to the United States. For Japan, China is not only a potential challenger, it is also an inescapable neighbor. It is right there next door, 1.3 billion people. And indeed, a number of Japa-

nese experts have said to me, "You know, one of the things which is almost as scary as the thought of a nationalist hostile armed China is a weak, divided China, which produces refugees, which produces political problems, which produces economic problems."

One of the things we have to worry about is not the Japanese economic meltdown, but what the implications are for the region of Chinese economic difficulties.

So you know, the Japanese have a very nuanced position. At the same time they look at what is going on in China. They see these sentiments. They listen, you know, to these Chinese soccer fans yelling "kill, kill, kill" and Chinese demonstrators throwing rocks at the Japanese Embassy. Naturally they feel alienated. Naturally they feel concerned, and I think we would too, and that is causing the Japanese, again, to try to reaffirm their alliance relationship with the United States. They are going to have to navigate this problem.

And I forgot what your last—Okinawa. Well, Okinawa is not a brand new issue. We have had it for a long time. It has—we have had ups and down. One should point out that while there is a strong anti-base sentiment in Okinawa, there is also a pro-base sentiment.

One of the things which I think the Japanese are trying to do, and I think the United States should join them, they have done since the 1970s, because the Japanese public, as I pointed out, is not necessarily exactly rah-rah-sis-boom-bah about the military. They have strong anti-military sentiments. But one of the things that they have done in terms of justifying the self-defense forces domestically is to emphasize their positive humanitarian role, their role in the disaster relief and dealing with things like volcanos in Japan in the 1970s, dealing with earthquake and so forth.

They are doing this internationally. That was one of the interesting things about the tsunami program. They are not extending that, and that has a positive impact on public opinion about the armed forces. And I think the United States should follow a similar kind of public relations program in terms of what good American forces are doing not only in supporting strategic military stability in East Asia, but also dealing with these kinds of natural disasters and other crisis.

Ms. WATSON. Just, if I may, Mr. Chairman, Koizumi, when he came into office, seemed to be kind of a new age leader and seemed to be very friendly toward the United States. Kind of following him, it seems like his popularity, he ran into some, I guess, fiscal issues and some of his popularity has kind of waned. Can you comment on that, anyone on the panel?

Mr. BERGER. The one thing—no, I will let Len do this.

Mr. SCHOPPA. I provided in my testimony some data on his public opinion ratings, and you can see that they have come down since the initial pop star period in which people were collecting all kinds of trinkets with his image on them. They are not doing that anymore, and there is kind of a disillusionment with the initial promise that he would change the LDP.

I think the reason he was so popular initially was because people hoped that as a rebel within the party he could change the party and change Japan through that process. I think they have been

disappointed that some of his efforts to change the LDP have come up short. He still has very strong opposition to many of his ideas, including the most recent high profile initiative, which is postal privatization, and when the public sees these prominent opposition figures within the party blocking some of his big ideas they conclude that the LDP has not really changed, and it has hurt his popularity.

Mr. KATZ. If I could add one thing to that.

Ms. WATSON. Please.

Mr. KATZ. First of all, I agree with Len. He failed to deliver on the advertising. He had the impression of a maverick. They used to talk about how his hair was so different. You know, he just looked different. He felt different. And the Japanese people do like mavericks to a certain extent.

He failed to deliver, and so he disappointed an awful lot of people. And the difficulty you get within the LDP itself, and also the opposition parties, is that a large part of the base, the money base and the voting base of the LDP would be very much helped by structural reform, but an awful lot of it would be hurt by it.

The same thing is true of the opposition parties as well. They are internally divided. So it is not a clean division of the party of reform versus the party of the status quo. They are all mixed up together.

I think the other issue that we need to be thinking about is that during the Cold-War era, the U.S. faced traditional trade-off between what were the United States security interests vis-a-vis Japan, and what were our economic interests. We often have this argument, well, we should sacrifice our trade interests because it is important to keep the Liberal Democratic Party in power. What does it gain us to sell a few more oranges in Japan if we are going to lose our right to bases?

We now have a situation where some of the people that we agree with on economic issues, economic reform that would make Japan stronger and a better ally, disagree with many of the stances the United States takes globally. For example, a large part of the opposition disagrees with sending Japanese troops to Iraq vis-a-vis the United States policy there.

And so I think one of the issues that we need to look at is that we not get back to the situation where once again we have this trade-off between our economic interests and our security interests, and that is a possible danger. Going forward I think the LDP will continue to weaken. I think it is likely that eventually it will split again, will break up, we will see a process of further political realignment in Japan, and that is part of the process of reform, and I think it is a multi-year process. Whoever succeeds Koizumi, I doubt he will be as popular as Koizumi was.

Mr. LEACH. Mr. Wilson.

Mr. WILSON. Thank you, Mr. Chairman, and Dr. Schoppa, I appreciate your recognition of Japanese-United States relations as a rock of stability, and that indeed we should be appreciating our friends as we consider crises around the world but not to ignore people who now we have gotten such a warm relationship with, and as was mentioned, with investments.

For example, in my home State of South Carolina, I have toured the Bridgestone Tire Company at Aiken, South Carolina, and the Utaca Technology Company at Lugoff, and these are enterprises where United States and Japanese workers work side by side. There is cross-training between the countries, and you would not anticipate that level of contact, but it is across—not just our State, but across the United States.

Additionally, I am very grateful for Japan, their response to September 11th. They too had been victims of terrorism. And so instead of being intimidated, obviously Japan was right there providing support for the liberation of Afghanistan by way of oil supply in the Indian Ocean, and then providing 600 troops.

I had a son serve in Iraq, and he told me of how impressed he was by the Japanese troops in the reconstruction projects, non-combat role that they have in Iraq.

But as I think of all the good, I appreciate Congresswoman Watson. She is very perceptive. She has jumped ahead to North Korea, and that is my concern. Indeed, the heinous barbarism of state-sponsored kidnapping that occurred in Japan. I mean, I cannot even imagine how horrible that must have been for the people.

Additionally, the missile test over Japan, and it has already been identified, and I would like all three of you to address, but you have indicated that a nuclear response by way of developing a nuclear weapon may not be the response. What will be or what is the best response for Japan to diffuse the tension on the Korean Peninsula? And we can begin with Dr. Berger and come to the right.

Mr. BERGER. Well, you are asking the 60 trillion yen question in some ways about the region. I mean, what to do with North Korea is something which I think is perplexing everyone.

From the point of view of Japan—and I am not going to try to address the issue in general as that would require another hearing, I would imagine, and I am not totally competent to address it—but I mean, from the point of view of Japan, they obviously on the one hand feel threatened by North Korea. They are more in the line of fire than we are. North Korean missiles could reach Japan, but they are not very accurate. There is evidence of North Korean—there is clearly a North Korean espionage network in Japan. There are fears that in the case of actual hostilities they could face both commando raids. North Korea is a very large and well-trained special forces, 100,000 of them actually who could pose some problems for Japan. The Japanese self-defense forces and defense agency are trying to deal with that.

You could face also the problem of agents using key positions, weapons of mass destruction in Japan, something the Japanese actually had experience with in the 1990s of the doomsday cult which used poisoned gas in the Tokyo subway.

So there are real security concerns emanating from North Korea. There are in Japan as a result of the incidents which has been referred to—the Taipuh Dong 1998 missile crisis, and other things, the Japanese have a very clear and dark image of North Korea.

Japanese friends of mine who—the Japanese television, Fuji television has been showing broadcasts from North Korean news, and Japanese look at these broadcasts. It is very sort of animated Communist commentators, listening to these threats periodically that

emanate from Yung Hang about turning Japan into a sea of fire in the event of hostilities. Their basic response is these folks are crazy. This is a threat.

At the same time the Japanese, I think, are worried about what actual contingencies on the Korean Peninsula would mean, and would probably prefer if at all possible to get the kind of thing which we are pushing for, a Libyan solution, a negotiated, complete and verifiable approach, and they are prepared to support the United States in pushing for that.

If we ever had to escalate beyond that, there would be some tough decisions that would have to be made in Tokyo about the kinds of risks that they face, but I think they are looking to the United States to take the lead on that, and they will burn those bridges when they get to them down the line.

Mr. SCHOPPA. The North Korean problem is vexing not only because of the North Koreans themselves, but because we have to coordinate such a diverse group of allies to really have any impact. It is not just the Japanese, of course, but the Chinese and the South Koreans who all have to come aboard our policy.

I think what stands out when you think about the Japanese views on this issue is how flexible they are compared to the Chinese and the South Koreans.

So if we can convince the South Koreans and the Chinese to go along with a tougher policy of threats of sanctions or imposition of sanctions, Japanese will be aboard. They will be aboard and willing to support that.

If we are unable to convince those other allies, the Japanese are probably going to just keep their heads down and counsel the Americans that really there is very little we can do in terms of economic sanctions without the support of these other two allies.

So the lesson, I think, is not to worry too much about the strong feelings in Japan, which are definitely there, but can be moved if we decide to go in a more cooperative direction or a more threatening direction. Much more depends on our ability to convince the South Koreans and the Chinese.

Mr. BERGER. One thing which I would like to add, the nationalism issue, the history problems are affecting relations between Japan and Seoul, and Japan and Beijing, and this is one of the potential casualties of this heightened tensions over nationalist issues, and can, as Chairman Leach already pointed out, become a problem for United States policy in the region pretty easily.

Mr. WILSON. As a person who has visited Pyongyang, I appreciate your trying to interpret it because it is certainly an enigma.

A final question, Mr. Chairman, is I was in Japan—excuse me—I was in China in January and I had the opportunity to visit Beijing again, and for the first time visited Shanghai, but I was so impressed at the economic vitality and dynamism that I saw there. But it occurs to me that the United States-Japanese relationship with two global powers integrating their economies, working together for mutual benefit of their citizens—could not Japan be a model for China of how China can work with the United States and maintain its sovereignty?

Mr. KATZ. I think, you know, China—since 1978, the entire modernization strategy of the Chinese Government has hinged on

globalization of its economy. It is actually a far more globalized economy than Japan's is. The ratio of trade to GDP is much, much higher in China than it is in Japan. The ratio of manufactured imports to GDP is much, much higher in China.

About 65 percent of China's exports are actually conducted by multinationals investing in China, and many of those multinationals are not from the United States or Japan. They could be from Korea. Korea, for example, has more direct investments in China than does Japan. They are from overseas Chinese of the offshore islands, from Singapore, Taiwan indirectly through Hong Kong.

So you have an economy which is—also, by the way, about 65 percent of the imports of China are also conducted through these multinationals. So the entire strategy toward modernization and industrialization of rapid growth hinges on China's internationalization.

So I think what that means is that China, the leadership of China recognizes that its ability to progress further to become stronger and more prosperous requires stability on its borders.

Aside from the issue of Taiwan, which is a very special issue for historical reasons, what Chinese officials have said to me is there is in fact no other issue which poses a fundamental conflict between the United States and China. Other issues, there may be differences of opinion and things may bump up against each other, and China certainly wants to assert itself as a rising influence in the area. But aside from Taiwan, there is no other issues which can cause a potential for a fundamental conflict.

So I think China simultaneously wants stability on its borders, very good economic and trade and investor relations with the United States as well as Europe, as well as its Asian neighbors, and yet to sort of assert its abilities, its prerogative both to make up for past humiliation of colonialism and just what it thinks is its rightful due. And so we see a little bumping up around some of these energy areas, and other issues of that type, but I think those are regarded as manageable issues rather than issues to be stoked and to inflame passion. So I think China does not see any conflict at all, quite the opposite, between its own prosperity and good relations with the United States.

Mr. WILSON. Thank you very much.

Mr. LEACH. Thank you. Mr. Paul.

Mr. PAUL. Thank you, Mr. Chairman.

I want to briefly make a comment about how I see some of the economic problems that Japan has faced over the years, and certainly since 1989. There has been significant problems there, and I am afraid they learned a lesson from us in the 1930s that they do not allow their markets to adjust. There was a tremendous amount of malinvestment in Japan and a tremendous amount of debt, bad debt that they kept on the books, and they had prolonged the agony. And in some ways I am afraid that for us to do a preaching is not going to do much good because we do not have a clean slate either when you think about our current account deficit, our financial situation here in Washington, the way we run Social Security, and the attempt at propping up our system as well since the year 2000.

Yes, we have sort of patched things together since 2000, but I am afraid we are slipping into the doldrums that Japan slipped to in the 1990s.

So I think we have a responsibility, but we have a responsibility to ourselves to do something rather than thinking that we can solve all their problems.

I am very sympathetic to the Chairman's concern, though, about the beef. I am from Texas and we have a couple head down there as well. But I see it in an economic term that the greatest penalty for Japan to put on sanctions or keep out our beef, the greatest penalty is on the Japanese. It is like a tax. They cut down on their imports and therefore the price has to go up, so there is a great penalty.

For us to retaliate in any way, I think would be, well, why penalize our people and tax our people as well even though, I think, the negotiations and the effort should be made so that we might be able to sell our beef there again, but I would hate to see us play the game of retaliation.

As a matter of fact, it was sanctions that we played games with in Japan in the 1930s that backfired on us as well when we dealt with oil embargoes.

But my question has to do more with the troops in Japan and in Korea, and the concern that has been expressed now about North Korea. But you know, our policy sometimes makes things worse over there because there seems to be a natural effort in this day and age for South Korea and North Korea to do things together and get along a little bit better. Then we raise cane because they want to deal with the so-called thugs in North Korea. And we express these great concerns about North Korea, but the odds of North Korea attacking the United States with nuclear weapons is just utterly remote.

I mean, we do not have to get tough with Pakistan. We do not have to get tough with India. So I would say, why do we not just get out of the way, let the South Koreans and North Koreans have a better balance? And getting out of the way, to me, would be, why do we not bring our troops home?

One of the most popular things I can say in my district is, why in the world do we have 53,000 troops in Japan and these thousands of troops in Korea for 60 years?

You know, I calculated in very rough terms in today's dollars that we have spent over a trillion dollars keeping troops in Korea. And if you add up what we spent in Japan, we are talking about trillions of dollars and we are talking about trillions, multi-trillions of dollars of obligations that this Government has. And had those trillions of dollars really been necessary for national security? I think it undermines our national security.

We have 53,000 troops, and if we are limiting this discussion to Japan, what would be wrong with this suggestion? Why do we not just make the announcement, make a decision and say, "Folks, our troops are coming home, we are going to be home in 4 years"? It would help our current account deficit. Instead of all those 53,000 troops spending all their money in Japan, you know, they would be in a base here at home spending their money.

So financially it would help us, and Japan would act in their self-interest. Why do we have to sit around and worry, well, what is Japan going to do? Well, they will do what is necessary. They are not going to attack us, and maybe they will, you know, learn to assume responsibility and we can save some money.

Where is the defect in just saying in 4 years bring home our 53,000 troops?

Mr. SCHOPPA. I am sure Mr. Berger will want to say some things about this too, but let me react to that.

I think what we need to remember is that the troops in Asia serve a multitude of functions. They are not just there to deal with the North Korean threat. Perhaps their most important role is to serve as insurance against great power competition reemerging in the region, or an arms race reemerging in the region, and the necessity at some later date for the Americans to come in and have to sort things out.

We know how expensive war can be when we actually have to send troops in and deal with a hostile situation. It is much cheaper to keep some troops in the region and maintain the basic status quo that has served most of those countries very well.

And I would not deny that there is room for readjusting the troops, moving some back to the United States, moving some around in the region. The United States Government is considering some of these options. But a wholesale withdrawal, I think, would be very unwise.

Mr. BERGER. Well, I think you have raised a lot of different points, and I think also with regard to the economic ones, Richard Katz might have something to say.

But with regard to the two strategic issues briefly, I think Len Schoppa has pointed out the general, the basic rationale, and you pointed out lessons from the 1930s.

Well, I mean, my sense is—and you have a better sense than I do—that American policymakers have drawn a particular lesson from the first half of the 20th century, from our experiences in World War I, World War II and the Cold War, and the basic lesson is that the United States can stabilize the world. It can help stabilize regions.

What we saw after World War I in particular was the United States pulled out after becoming very involved in European affairs, coming out of isolation, and the world went to heck in a handbasket, and as a result we got pulled back in at a greater cost in blood and treasure, both the United States as well as the rest of the world.

During the Cold War, we fought the long twilight struggle. We fought it to a successful end from our point of view, the fall of Communism, and it was expensive. But if we had actually had another war, let us say in the European continent involving the former Soviet Union in the 1950s, could we have ignored it? Would we not have gotten pulled back in?

And we look at—knowledge is always misleading, and we should always doublecheck our thinking on these things, and I am very sympathetic with a lot of what you are saying here. I also think our Asian partners should not overlook the fact that, you know, we

are not there—we are not a natural feature of the landscape. We could at some point leave.

But on the other hand, there are, and these current problems that we are seeing in East Asia reflect that, there are possibilities for great power rivalry, especially between Japan and China, that could involve other powers like India and Russia, which we have not talked about at all, but which also abut strategically in different ways, and we could see an unholy mess developing.

So far, actually while we talk about how unstable the Asian region is, it is worth reflecting upon how relatively stable it has been for over—we have not had any kind of major militarized conflict involving a great power since 1979, with the Vietnamese-Chinese war disputes. It is a pretty good deal. If we can keep that going with the help of our allies, I think that is right.

Now, with regard to North Korea, just one thing. I think you are absolutely right, the possibility of North Korea attacking us, trying to play Sampson in the temple, that is not very likely.

There are two other things that we do have to worry about. One is the possibility of transfer.

Mr. PAUL. Pardon me?

Mr. BERGER. Transfer. I mean, North Koreans have developed that capability. They have the kind of regime which might share those kinds of capabilities with other actors, not only state, but even more worryingly, non-state actors, and that is something we have to be very, very worried about after September 11.

The other thing is also, of course, how North Korea may be undermining or contributing to the undermining of the nonproliferation regime. There are a lot of countries which could go nuclear in the world. And if North Korea can demonstrate that it pays to take this kind of stance on nuclear issues, we have to worry about other countries.

Mr. PAUL. But should we not worry about Pakistan transferring too?

Mr. BERGER. I think you are absolutely right. I am not here to talk about Pakistan.

Mr. PAUL. No.

Mr. BERGER. And I do not pretend to be an expert on that issue. We are working with Pakistan. Actually, the current Government in Pakistan is more responsible than the regime in Pyongyang, but we need to be sensitive to these issues. You are absolutely correct.

Mr. PAUL. May I follow up, Mr. Chairman?

Mr. LEACH. The first two speakers used excessive time, the last should be entitled to the same.

Mr. PAUL. Oh, thank you very much.

I do want to address one word that you used when you talked about the thirties and this isolation. I think there is a big distinction from the position I hold versus the isolation of the thirties, because I want to diminish military presence because I think it is an unwise investment and leads to too many unintended consequences, and we are witnessing currently what is going on in the Middle East today.

I want to increase economic relationships. I do not want terrors. I do not want barriers. I want to be involved. I want to encourage investments, and that is why I like to see Taiwan investing in

China and visa-versa, and Japan going to China, and the more the merrier. So that to me is a lot different than the protectionist isolationist's viewpoint of the thirties, and this is more the traditional American position that we do not get our troops every place, and eventually I am going to win the argument.

So no matter how much you disagree with me, I win because we do not have the money. We are going broke, and our dollar is going to crash, and the economics will control my position because we just cannot maintain this military empire around the world. We are short troops now.

They are talking about going into Iran. Where are they going to get the troops?

But the one last question is, since nobody wants the troops to leave so far from the panel, this means then I should assume that your advice would be, or your inference would be, that we are going to be there indefinitely so that we can come back here in another 55–60 years and say, “I wonder when we are going to bring the troops home from Japan?” That will not last, as I say, because we will go broke. Thank you.

Mr. LEACH. As Chair, let me just comment. The gentleman from Texas always brings insight to this panel, and I would like to pick up on one theme that is partly the gentleman's, that if we look at history, tariff barriers that became competitive created economic difficulty and military difficulty.

One of the extraordinary phenomena that is more nuanced today are non-tariff barriers, and nobody wants to see a competitive erection of non-tariff barriers, one of which is food safety, which is a legitimate concern of many people in the world. But it can also be a non-tariff barrier to open trade, and that is a classic circumstance, and I think it is one that we should have our eyes on, and the Japanese should be very sensitive to as we should be.

And it is extraordinary. I mean, as a Representative of a mid-western State to see countervailing tariffs placed on American food products based upon, (A) safety concerns in Europe, and (B) irrational actions of the United States Congress on things like steel. That became the cause of putting countervailing tariffs on American food exports. I just think that this is something that one should be very concerned about in the world.

Let me turn a little bit to Japan because Japan is exhibiting strengths and weaknesses that are very much in the realm of future lessons for the United States. We think of our own economy as being a lesson for others in some ways, both good and bad, largely good. But it strikes me that many of the problems that Japan is facing are problems like the one the United States is facing, although the good news for America is we are in a much lower relative position in terms of national debt, as well as in terms of demography.

Here, I am reminded that around 1990, Lee Kwan Yu visited several of us on Capitol Hill, and he made the comment about Japan; that sociologically the great difference between Japan and America that favored America was that we were an immigrant society, and Japan is anti-immigrant. And if we did not have ceratin levels of immigration—some of which we find very difficult, par-

ticularly on the illegal side—we would be becoming much more elderly than we currently are.

Now, Japan is becoming elderized, and your statistics on the number of workers supporting their retirement system is going to be very difficult for Japan as it is somewhat difficult for the United States.

But this sociological attitude toward immigration is something that is potentially going to be self-defeating for Japan.

Do you see any change in their attitude toward immigration?

Mr. KATZ. Well, first of all, I agree with your analysis. I mean, if you look at who works there. Globalization, in fact, is certainly key to the U.S. competitive strength. I do not see any significant change in that in the near future. That is a debate which is beginning. There are certain sectors of what are sort of called dirty work, or hard work, you know, in certain areas you will get a certain amount of immigrants, and certainly in illegal activities you get a certain amount of immigrants.

But at the kind of mass guest worker program let alone the kind of immigration we have in the U.S. where immigrants become citizens as opposed to simply permanent guest workers, either one of these things, I think change of attitudes in that direction is far off.

It has been discussed in the papers back and forth, but I do not see any change in that attitude.

Mr. LEACH. Dr. Berger.

Mr. BERGER. Well, I will disagree a little bit with my colleague, and I have done some research on this both in Japan and in the comparative context. By the way, I am a product of immigrants myself, and married to an immigrant to the United States. I am fully appreciative of the unique character of the United States in this regard.

Japan clearly historically has not been a country of immigration in any way comparable to the United States, and attitudes toward immigration, toward foreigners in general is different. Nonetheless, if you take a look at what has been happening slowly, and I think quite surely, you are seeing some changes, and we have seen those kinds of changes in other societies in Europe.

I mean, I also work on Germany as a country. Germany had this closed ethnic sense of identity in modern times as any you are likely to find. It has now got a population which is about 10 percent foreign residents, and they have changed the citizenship laws in order to make Turks and Yugoslavs, and Russians, to allow them to become German citizens.

I think that the Japanese have a long way to go before they go in that direction, 10–20 years, but they are moving. The foreign resident population in Japan has been increasing. While we have some anti-immigrant sentiments on the margins in Japanese political system, we have not seen the kind of emergence, with the few exceptions like the Government in Tokyo which has made some strong anti-immigrant statements, but I cannot think what we are seeing, and the Japanese Government is very sensitive to this issue. They look at anti-immigrant movements which have appeared in countries like Austria, like France, everywhere we have had that backlash against immigration, we have seen the rise of

far right parties, and the Japanese are sensitive to that example. But so far we have not seen that.

At the same time what we are seeing is that increase, and it is very difficult for the Japanese, as in the Japanese police officials and members of Japanese labor ministry, it is very difficult for them as it is for all of us, including the United States, to get a handle on immigration population. There is a powerful push as well to factors which are increasing that foreign population, and the Japanese are thinking very seriously, and they are trying to implement ways of integrating that foreign population.

So I think we are going to see some changes in Japan. They are going to become more multi-cultural in the same way that we have seen previously monocultural ethnically-oriented countries—Sweden, Germany, Holland—also moving in a more diverse—I will not use the word “multi-colorful,” it is too loaded—but a more diverse kind of background.

By the way, the United States also has gone through periodic, and here I will mention one sort of, I think, corporate interests on our part as members of the university, America has also gone through periods of being very acceptance of foreigners and being much more restrictionist toward foreigners.

We talk about the lessons of history. We can go back to 1919, 1920 when the U.S. Government passed very, very strong anti-immigrant restrictionist policies.

As a member of the university, which has a lot of foreign students, I must say we feel, even though we are not anywhere near in that—to being a real restrictionist policy, but we certainly feel the economic as well as the social and cultural impact of the toughened visa rules that we have implemented in this country. We are seeing a lot of very bright, young, capable scholars, scientists, technicians and students who are finding it very hard to come.

So we do hope that the U.S. Government views that issue very carefully.

Mr. LEACH. Well, I appreciate that bit of advice, and I share your concern on the student issue. It is an economic issue as well as a cultural circumstance, and we are injuring ourself out of fears that are being taken out in the wrong way and the wrong group of people in many instances.

Does anyone want to give any concluding comments? I know you have things—

Mr. KATZ. Just a couple of things.

Mr. LEACH. Yes, Mr. Katz.

Mr. KATZ. There was some concerns expressed by the Congressman from Texas about the United States getting into trouble the way Japan got into trouble. I think the U.S. is totally a different ballpark. It takes pretty hard work to get yourself in this much trouble as Japan did. And while the U.S. has got its problems, I think the view that the U.S. could head down that road, I think, is a greatly exaggerated danger. It does not mean you should ignore the problems, but I think we should not be overly alarmist as well.

And on the beef issue, just a tactical thing. I would be interested to hear what Len has got to say on that as well.

Two things: One is, I think in terms of moving the process along in Japan, I think we had an overwhelming vote in the Senate a few weeks back to lifting the import on Canadian beef. I think it helps the United States position vis-a-vis Japan if we lift that ban on Canadian beef.

Secondly, I think the right tactic for the Congress to take depends partly on your attitude to what you think is the—your assessment of the attitude of the Koizumi Administration and ministries. If you believe the Koizumi Administration and the ministries are simply using the food safety issue as a pretext to protect its cattle interests, then you might want to have a harsher tactic.

I do not think that is the case, I think—

Mr. LEACH. Let me stop you right there, Mr. Katz.

Mr. KATZ. Sure.

Mr. LEACH. That is not the standard. The standard is what is the national position of a sovereign state. Whether you have a well-intended politician with diabolical motivations, or less well-intended, or betterly-intended politician matters less than the effect, and we had one instance of mad-cow, a Canadian cow in the United States, which we dealt with with perfect precision.

Based on that, a sovereign state has used that as a rationale for refusing to accept a quality American product, and the issue is not the motivations of a government, it is the effect, and the effect is self-evident, and it is irrational, and it is unfair. And in trade one seeks fairness, and if one cannot find fairness, one opens up to countervailing attitudes and actions. And of all countries of the world the one that should be the most apprehensive about that is Japan.

I do not think it is irrational for me, as a public official of the United States of America, to point this out, and I mean, it comes back exactly to—I mean, analog actions in Europe, which you might say, well, they do not matter that much because the public really is concerned about such and such or such and such. The issue is fairness, and we will always be disadvantaged if we do not raise this, and I think we must, and I do not think we lightly excuse it.

Mr. KATZ. I agree with you.

Mr. LEACH. Okay.

Mr. KATZ. I am just talking about from a tactical standpoint the best way to move forward more quickly than it has been, and I was addressing the issue that was raised by the Congressman about leveling sanctions against Japan, whether that would help move it forward or move it backward, and I think that is the case where I think it would move it backward. It would not—it could backfire.

Mr. LEACH. Well, that is quite possible. But let me ask you this. How does America stand up in the world for its trade if willy-nilly other countries for good or bad reasons put barriers that on any basis of neutral judgment are irrational? And you open up Pandora's Box. So all I am suggesting is close it.

Well, anyway, thank you all, and I appreciate your testimony. I even appreciate Mr. Katz for bringing a given perspective. This has been a very thoughtful hearing. Thank you all.

Mr. KATZ. Thank you.

Mr. BERGER. Thank you very much.

Mr. SCHOPPA. Thank you.

Mr. LEACH. The Subcommittee is adjourned.

[Whereupon, at 12:22 p.m., the Subcommittee was adjourned.]

A P P E N D I X

MATERIAL SUBMITTED FOR THE HEARING RECORD

PREPARED STATEMENT OF THE HONORABLE DIANE E. WATSON, A REPRESENTATIVE IN
CONGRESS FROM THE STATE OF CALIFORNIA

Dear Mr. Chairman:

I want to thank you for holding this hearing and I welcome our witnesses. In view of many observers, a new Japan appears to be emerging. Japan seems more nationalistic, willing to assert its national interests and less willing to engage in global security challenges.

While current interpretations of Japan's war-renouncing constitution still prohibit the use of force except for the defense of Jaapan, regional security interests, like North Korea missile tests, abduction of Japanese citizens, and the rise of China, have been a major driving force of Japan's decision to strengthen the U.S. Japan alliance and to move forward with its own defense transformation.

Japan's bid for permanent membership on the UN Security Council and territorial disputes with China have also challenged Japanese diplomacy in Northeast Asia. A similar set of disputes has also soured Japan's relations with South Korea.

Despite these challenges, Prime Minister Koizumi is committed to an ambitious agenda that includes revising Japan's constitution and tax reform. Today, Japan accounts for more than 9% of the global GDP, 60% of East Asia's GDP, and is the world's second largest economy.

We publicly commend Japan and the Koizumi government for the passage of unprecedented legislation permitting the dispatch of forces to the Indian Ocean to provide rear-area, non combat logistical support to U.S. forces engaged in the anti-terrorist campaign in Afghanistan. In early 2004, Japan also sent some 600 non-combat military and reconstruction troops to Iraq and extended deployment beyond its initial one-year limit.

The U.S. maintains approximately 53,000 troops in Japan, about half of whom are stationed on the island of Okinawa. As the U.S. re-aligns its global forces, we are hopeful that Japan will work with us to achieve the overall strategic cohesion that was hoped for when the revised Guidelines for U.S. Japan Defense Cooperation were announced in 1997.

At this time, we are interested in knowing when and how U.S. military basing in Japan will be adjusted? Given current uncertainties in Northeast Asia, is there a plausible scenario in which Japan might acquire nuclear weapons and adopt a doctrine of preemption? Can Japan achieve a leadership role in Asia and a permanent seat on the UN Security Council without reaching some accommodation with China and South Korea on historical issues and regional concerns?

These are the questions that must be answered and I look forward to hearing from our witnesses.

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